

Minnesota

Department of Finance

November 2000

Highlights

\$924 Million Available for Rebate in Summer 2001

Minnesota's expected general fund balance at the close of FY 2000-01, excluding reserves, is now forecast to equal \$924 million. As required by law, the Commissioner of Finance has designated that amount as available for rebate. FY 2000-01 revenues are forecast to exceed end-of-session projections by \$865 million, or 3.6 percent. Estimated expenditures are down by \$41 million.

Revenues Exceed Expenditures by \$2.086 Billion in FY 2002-03 Forecast

A forecast of continuing, very strong economic growth has improved the budget outlook for FY 2002-03. Current resources are projected to total \$28.211 billion and expenditures, \$26.125 billion. The available balance for the 2002-03 biennium is now expected to total \$2.086 billion.

Almost all of the revenue growth in FY 2002-03 comes from the income and sales taxes. Those two taxes account for \$3.393 billion of the projected \$3.500 billion growth in projected general fund receipts. The sales tax growth is from a base reduced by the sales tax rebate paid earlier this year. Motor vehicle sales tax receipts fall by \$125 million, reflecting a law change dedicating 32 percent of collections in FY 2003 and beyond to the Highway Fund.

Growth Expected to Continue through FY 2005

DRI believes the current economic boom will extend through 2005. That continued strong economic growth, building on the high level of economic activity forecast for 2003, produces a FY 2005 structural balance of \$1.538 billion. Structural balance, the difference between long-term revenue and expenditure planning estimates, defines the affordable limit for any package of future tax cuts or spending increases.

DRI Outlook Is More Optimistic than Most Forecasters

DRI's November Control forecast (55 percent probability) calls for real GDP growth at a 3.6 percent rate in 2001, followed by growth at 4.3 and 4.8 percent annual rates in 2002 and 2003. The individual forecasts of members of Minnesota's Council of Economic Advisors were all less optimistic than DRI. The Blue Chip consensus forecast calls for 3.4 percent real growth in 2001, and 3.3 and 3.2 percent growth in 2002 and 2003.

November 2000 Economic Forecast

Budget Summary

\$924 Million Surplus for FY 2001 Expected from Strong Economic Growth and Higher Tax Revenues

Stronger than anticipated U.S. economic growth has lead to an increase in the revenue forecast for FY 2000-01. State expenditures are now forecast to be \$41 million below end-of-session estimates. The combined impact of significantly higher revenues and slightly lower spending has increased the expected ending balance forecast for June 30, 2001 from \$9 million to \$924 million, a net change of \$915 million.

FY 2000-01 Forecast (\$ in Millions)

	<u>End of Session</u>	<u>November Forecast</u>	<u>Change</u>
Beginning Balance	\$1,921	\$1,921	\$0
Revenues	23,028	23,898	870
Other Resources	<u>817</u>	<u>812</u>	<u>(5)</u>
Total Resources	25,766	26,631	865
Expenditures	24,640	24,599	(41)
Cash Flow Account	350	350	0
Budget Reserve	622	622	0
Dedicated Reserves	<u>145</u>	<u>136</u>	<u>(9)</u>
Available Balance	\$9	\$924	\$915

Statute Defines Rebate Requirements

In 1999 legislation was adopted governing treatment of projected balances in the November forecast of even-numbered years prior to the end of the biennium. Minnesota Statutes 16A.522 requires that the Commissioner of Finance designate a surplus that exceeds one-half of one percent of general fund biennial revenues as available for a tax rebate. The current forecast exceeds that threshold.

Minnesota statutes also require the Governor to present a plan to the 2001 Legislature to rebate the designated amount with payments beginning no later than August 15, 2001. The 2001 Legislature is required to enact, modify or reject the Governor's plan for the rebate by April 15, 2001.

Revenue Forecast for Current Biennium Up \$865 Million from End-of-Session Estimates

General fund revenues are now projected to be \$24.710 billion during the 2000-01 biennium, up 3.6 percent from February's forecast after adjusting for action by the 2000 Legislature. The forecast for each of the four major taxes increased. In total the forecast for those four taxes exceeds end-of-session estimates by 3.7 percent. Almost 40 percent of the projected surplus has already been collected. The remaining 60 percent reflects revenue collections beyond those previously forecast between now and June 30, 2001.

A large jump in DRI's corporate profits forecast for 2000 produced a \$180 million (12.2 percent) increase in projected corporate income tax revenues. That change in anticipated corporate profits more than offsets DRI's February reduction in their outlook for corporate profits. Forecasts for the individual income tax, sales tax and motor vehicle excise tax revenues were raised to reflect the improved economic outlook and higher collections observed in fiscal 2000.

FY 2000-01 Revenues
(\$ in Millions)

	<u>End of Session</u>	<u>November Forecast</u>	<u>Change</u>	<u>Pct.</u>
Revenues				
Income Tax	\$11,036	\$11,441	\$405	3.7
Sales Tax	6,910	7,059	149	2.2
Corporate Income Tax	1,482	1,662	180	12.2
Motor Vehicle Sales Tax	<u>1,055</u>	<u>1,077</u>	<u>22</u>	<u>2.1</u>
Subtotal Major Taxes	20,483	21,239	756	3.7
Tobacco Settlement	222	220	(2)	(1.0)
All Other Non-dedicated	<u>2,323</u>	<u>2,438</u>	<u>115</u>	<u>5.0</u>
Subtotal Revenues	23,028	23,898	870	3.8
Transfers, Other	<u>817</u>	<u>812</u>	<u>(5)</u>	<u>(0.6)</u>
Total	\$23,845	\$24,710	\$865	3.6

Net Expenditure Savings of \$41 Million in Current Biennium

Forecast spending for the current biennium has been reduced by \$41 million, 0.2 percent, from end-of-session estimates. K-12 education spending is expected to be nearly \$16 million higher due to increases in the number of projected students, but this is more than offset by a \$55 million reduction in expected health care program costs. Declining costs in the Medical Assistance program -- due to lower caseloads in long-term care facilities and less spending for services -- provide the majority of the savings. Other spending areas show modest changes from previous estimates.

FY 2000-01 Expenditures
(\$ in Millions)

	<u>End of Session</u>	<u>November Forecast</u>	<u>Change</u>	<u>Pct.</u>
K-12 Education	\$8,282	\$ 8,298	\$16	0.2
Post-Secondary Education	2,641	2,641	0	0.0
Prop. Tax Aids, Credits	3,294	3,288	(5)	(0.2)
Other Major Local Assistance	1,169	1,165	(3)	(0.3)
Health Care	3,753	3,698	(55)	(1.5)
Family Support	431	434	3	0.7
Debt Service	579	567	(12)	(2.0)
All Other	<u>4,491</u>	<u>4,508</u>	<u>17</u>	<u>0.4</u>
Total Spending	\$24,640	\$24,599	\$(41)	(0.2)

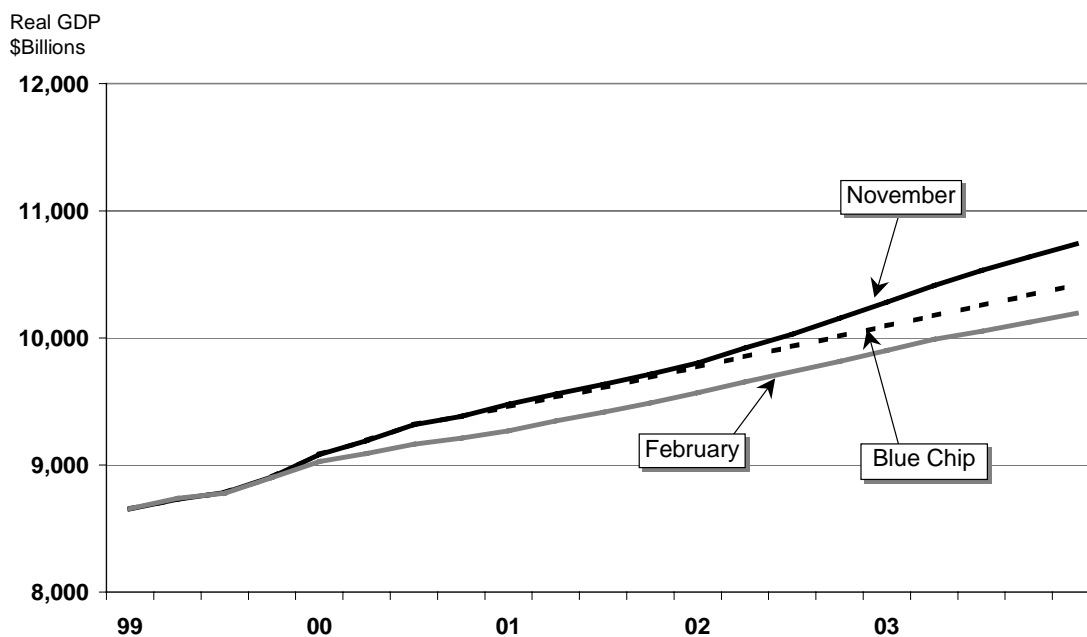
Seven major program areas account for 82 percent of general fund spending. They are the programs most likely to be affected by forecast changes in enrollments, caseload, and current law formulae. With few exceptions "all other" spending -- including legislative, judicial, state institutions and state agency operations -- is limited to specific amounts set in law for the biennium. Changes in "all other" spending are limited to authorized transfers between agencies, cancellations of excess funding at year end, authorized carry forward of unspent appropriations between years or biennia, and technical adjustments.

DRI's Control Forecast among Most Optimistic for 2001-03

All forecasters have raised their estimates for real GDP growth in 2000 and 2001 since last February. Most believe the Federal Reserve has successfully negotiated the minor, mid-course correction thought necessary to keep inflationary pressures at bay. Further increases in the productivity growth rate appear sufficient to support a higher sustainable growth rate than previously thought possible without triggering an up-tick in inflation.

No one is forecasting a recession, or even a serious slowdown through the end of 2003. The only question is how fast can the economy grow. On that issue there is a wide divergence of opinion. Data Resources Inc., (DRI), the state's macro-economic consultant is now among the most optimistic of all national economic forecasters. After characterizing their October Control as a forecast "where nothing ever goes wrong," DRI again raised their forecast in November. The November Control calls for real (inflation adjusted) GDP growth at a 3.6 percent annual rate in 2001, followed by real growth rates of 4.3 percent in 2002 and 4.8 percent in 2003. Those growth rates are roughly one-third higher than real growth rates observed in the early years of this economic upturn. They are also well above the Blue Chip Long Range Consensus projections. Indeed, DRI's forecasts for 2002 and 2003 are higher than the average of the ten highest forecasts reported in the Blue Chip Survey. After several years of out-year forecasts more cautious than most, DRI's new national economic model now projects stronger than consensus growth rates through 2003.

November Control Is More Optimistic Through 2003



For DRI's forecast to come true two key assumptions must hold. Strong productivity growth must continue, and oil prices must begin to fall. The November Control assumes output per hour grows at a 3.7 percent average rate through 2003. That rate is faster than the 3.3 percent average rate observed during the past three years, and nearly triple the average growth rate observed from the mid 1970s to the mid 1990s. The Control forecast also assumes oil prices average \$26.50 per barrel in 2001, and just over \$23 per barrel in 2003. Recently, crude oil prices have been in excess of \$30 per barrel.

National economic growth will fall well short of the November Control projections should either of these assumptions not be met. DRI assigns a 55 percent probability to the Control. DRI's High Oil Scenario (probability 20 percent), provides an indication of their importance. In that scenario, oil prices remain at \$30 per barrel through 2002, then decline to \$23.50 in 2003. Under those assumptions real growth rates for 2002 and 2003 are on average 0.5 percentage points lower than in the Control. The other alternative (Pessim) has a recession occurring in mid 2001 and has an assigned probability of 25 percent.

Projected Balance for 2002-03 Biennium is \$2.086 Billion

In this session the Governor and the 2001 Legislature will set a budget for the two years beginning July 1, 2001. This revenue and expenditure forecast provides the basis for the Governor's budget proposals. The revenue forecast replaces the long-term planning estimates previously used to highlight potential discrepancies between the future cost of spending proposals and expected future revenues. It is the first detailed forecast for the 2002-03 biennium.

Since there is no budget currently in place, projections of FY 2002-03 expenditures assume the extension of current law and policies. Those estimates are adjusted for expected changes in enrollments and caseload. Inflation, estimated at 2.0 percent per year--down from the 2.5 percent per year in end-of-session estimates--is included in the expenditure projections to account for potential cost pressures on the delivery of state services.

FY 2002-03 Budget Outlook
(\$ in Millions)

	<u>FY 2002</u>	<u>FY 2003</u>	<u>Total</u>
Forecast Revenues	\$13,764	\$14,447	\$28,211
Projected Spending			
Current Law	12,638	12,750	25,388
Estimated Inflation	<u>240</u>	<u>497</u>	<u>737</u>
Total Spending	12,878	13,247	26,125
Difference	\$886	\$1,200	\$2,086

The November forecast defines the resources available for the Governor's budget. The \$2.086 billion difference between forecast revenues and estimated spending represents the total amount available for tax cuts or state spending increases for the 2002-03 biennium. That \$2.086 billion balance is in addition to the \$924 million balance projected for fiscal 2000-01.

FY 2002-03 General Fund Revenues Now Forecast at \$28.211 Billion

Total current resources for the 2002-03 biennium are forecast to be \$28.211 billion, up \$1.625 billion, (6.1 percent) from February's revenue planning estimates after adjusting for actions by the 2000 legislature.

General fund receipts from the four major taxes are now projected to grow by 15.7 percent over levels forecast for the current biennium. Comparisons to the previous biennium may be misleading, however, since there have been a number of material changes in the state's revenue structure. Those changes include an income tax rate change partway through the 2000-01 biennium, a \$636 million sales tax rebate in fiscal 2000, and the dedication of 32 percent of motor vehicle sales tax revenues to the Highway User Fund beginning in fiscal 2003.

FY 2002-03 General Fund Revenues

	<u>FY 2000-01</u>	<u>FY 2002-03</u>	<u>Change</u>	<u>Pct.</u>
Revenues				
Income Tax	\$11,441	\$13,293	\$1,852	16.2
Sales Tax	7,059	8,600	1,540	21.8
Corporate Income	1,662	1,735	73	4.4
Motor Vehicle Sales	<u>1,077</u>	<u>952</u>	<u>(125)</u>	<u>(11.6)</u>
Major Taxes	21,239	24,580	3,287	15.7
Tobacco Settlement	220	640	420	191.0
Other Revenues	2,438	2,628	190	7.8
Other Resources	<u>812</u>	<u>363</u>	<u>(450)</u>	<u>(55.3)</u>
Total Resources	\$24,710	\$28,211	\$3,500	14.2

Spending Increase for FY 2002-03 Projected at \$1.5 Billion

Projected spending for the FY 2002-03 biennium, including estimated inflation, is expected to reach \$26.125 billion, an increase of \$1.526 billion, 6.2 percent, higher than the current biennium.

Spending for health care programs continues to be one of the largest and fastest growing areas of the budget. Projected health care spending increases for FY 2002-03 are the result of increasing caseloads and general increases in the cost of health care, and a reduction in the federal matching rate. While pupil estimates are expected to decline slightly, the continued growth in the costs of K-12 education is largely attributed to FY 2001 formula increases as well as the effect of estimated inflation.

FY 2002-03 Expenditure Estimates

	<u>FY 2000-01</u>	<u>FY 2002-03</u>	<u>Change</u>	<u>Pct.</u>
Spending				
K-12 Education	\$ 8,298	\$ 8,825	\$ 527	6.4
Health Care	3,698	4,747	1,049	28.4
Property Tax Aids, Credits	3,288	3,543	255	7.7
Post-Secondary Education	2,642	2,749	107	4.1
All Other	<u>6,673</u>	<u>6,261</u>	<u>(412)</u>	<u>(6.2)</u>
Total	\$24,599	\$26,125	\$1,526	6.2

All other spending is expected to decline from the current biennium due to significant one-time spending for general capital projects, state agency operations, and transportation projects.

Planning Estimates Show \$1.5 Billion Structural Balance for FY 2005

This report provides the first revenue and expenditure planning estimates for the 2004-05 biennium. These planning estimates provide a necessary framework against which the potential impact of FY2002-03 budget decisions can be judged. The planning estimates do not include any tax or spending decisions beyond those in current law.

Current law spending estimates have been adjusted to reflect enrollment and caseload growth in entitlement programs and where statutory formulae are present. The potential impact of inflation over the period is identified separately. Current law spending is displayed in current dollars (FY 2001). The FY 2004-05 planning estimates assume 2.5 percent per year inflation – compounding on the 2.0 percent per year estimated for FY 2002-03.

FY 2004-05 Planning Estimates (\$ in Millions)

	<u>FY 2004</u>	<u>FY 2005</u>
Forecast Revenues	\$15,240	\$16,032
Projected Spending		
Current Law	13,009	13,301
Estimated Inflation	<u>832</u>	<u>1,193</u>
Total Spending	13,841	14,494
Difference	\$ 1,399	\$ 1,538

Projected revenues for FY 2004-05 reflect the trend of continued growth forecast for FY 2002-03. The expenditure and revenue planning estimates make no assumptions about actions in the 2001 legislative session. The FY 2004-05 planning estimates represent a benchmark to determine if ongoing spending exceeds revenues in succeeding budget periods. Economic changes, as well as the amount and timing of tax and spending changes, will materially affect revenues and expenditures in the FY 2004-05.

Forecast Fundamentals: About the Revenue and Expenditure Forecast

The November forecast provides the starting point for FY 2002-03 budget considerations in the 2001 legislative session. The forecast provides revised revenue and expenditure estimates for the current biennium based on the most recent information about the national and state economic outlook and caseload, enrollments, and cost projections. Additionally, this forecast provides closing balances for FY 2000 and compares how actual revenue collections for the current year compare to the forecast.

The revised forecast for the current FY 2000-01 biennium is followed by a forecast for the next budget period, FY 2002-03, and by planning estimates for the FY 2004-05 biennium. Planning estimates should not be interpreted as explicit forecasts, but rather as a guide to indicate whether proposed actions will create financial problems in future years.

Revenue estimates for the current year and next biennium are based on econometric models that forecast the Minnesota economy. The revenue forecast is prepared based on a national economic forecast provided by Data Resources Inc., (DRI). That national forecast is reviewed by Minnesota's Council of Economic Advisors and their comments on it are found in the "Economic Summary". The "Economic Outlook" which follows provides a comprehensive overview of the current outlook for the U.S. and Minnesota Economy. The planning estimates for FY 2004-05 are obtained from less complex models and are driven entirely by the long term national economic outlook of DRI.

Expenditure estimates in most areas are shown at the level of the appropriations made during the 1999 and 2000 legislative sessions, plus any authorized spending carried forward from prior years. Entitlement programs -- such as K-12 education, property tax aids and credits, health care, and family support -- are forecast based on expected changes in eligibility, enrollment, and average cost. To that base level spending, 2.0 percent per year for FY 2002-03 is added to represent the potential effect of inflation. For FY 2004-05, the estimated inflation is 2.5 percent per year.

The forecast does not reflect the Governor's budget recommendations, or potential legislative action, only current law. The difference between the forecast and the budget process is clearly defined, but often confused. Presentation of the current law forecast for various areas will likely be accompanied by discussion of possible future legislative changes. The forecast presents only a current law framework for these discussions. Similarly, a forecast increase in spending for any area in the current biennium - or estimated inflation in planning estimates for the next biennium -- does not preclude the Governor or the legislature from proposing budget changes that will have a significantly different result than that shown in the current forecast

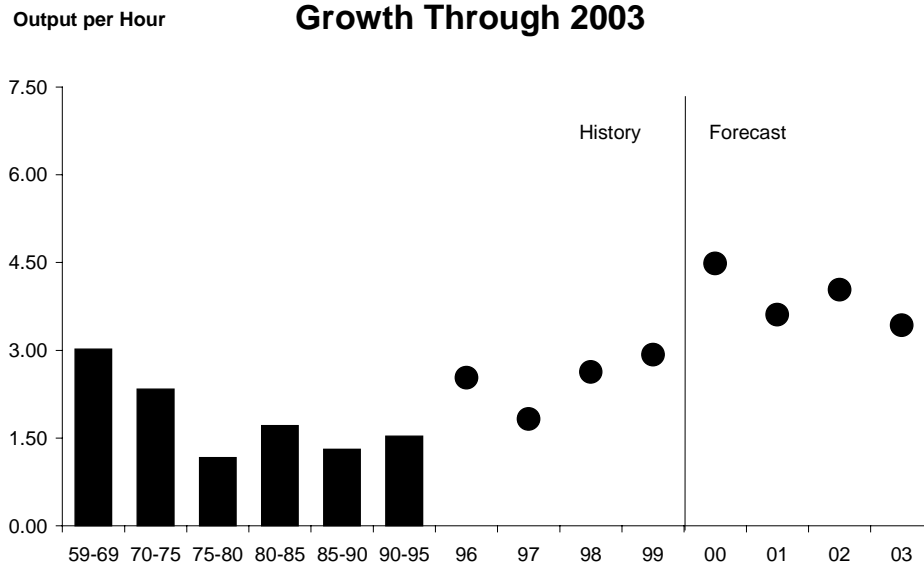
Economic Summary

The U.S. economy is in great shape and everyone knows it. Preliminary third quarter 2000 figures showed real GDP growth at slightly less than half the second quarter's rate. But an annual growth rate of 2.7 percent, while well below the level observed during the past few years, is no harbinger of recession. No one expects 2000 to close with a repeat of last year's 8.3 percent fourth quarter growth rate, but even with high oil prices, a weak stock market, and an increasing trade deficit, there is no reason to expect the economy to slip into recession.

Forecasters are not focused on determining when the next recession will begin. Their concern is with the more immediate question of how good can the good times be. Only a few years ago most believed that for the long-term, annual real growth rates of 2.5 percent (or less) were reasonable. Growth rates above that level were possible over the short term, but with productivity growth of less than 1.5 percent per year and labor force growth of 1 percent per year a continued pattern of economic growth which exceeded that 2.5 percent speed limit, was believed to lead to a resurgence in inflation.

Beginning in 1996, however, productivity (output per hour) took off. (See graph) In 1997, output per hour grew more slowly than in 1996, but productivity growth was still well above the average observed since the mid 1970s. In 1998 and 1999, growth in output per hour continued along what appears to be a new path, and in 2000, there were further increases. Since 1996, U.S. productivity has grown at an average rate of more than 2.5 percent. Should productivity continue to grow at the rates observed during the past five years, forecasters believe that the economy can grow at rates of at least 3.5 percent per year, and perhaps even more, without creating inflationary pressures.

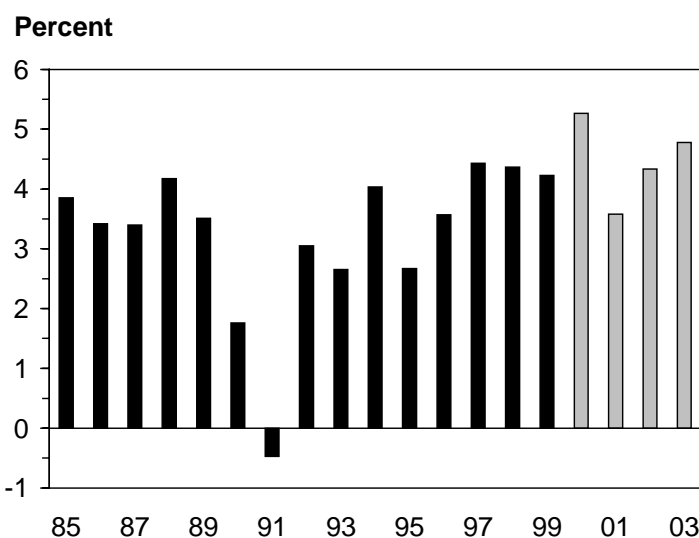
DRI Expects Very Strong Productivity Growth Through 2003



Documenting productivity improvements by measuring changes in output and hours worked over time is a relatively straightforward task. Identifying the factors leading to what has caused output per hour to change is not. That means economists are left to rely on recent trends and their intuition for this key portion of their forecasting models. Forecasters' inability to anticipate the apparent change in productivity, and their subsequent delay in changing the outlook for productivity growth has been a key reason behind the unduly cautious national economic forecasts of the past 5 years.

All forecasters have re-thought their productivity assumptions and their models have been revised accordingly. DRI is among those making the largest changes in their outlook. DRI now expects the annual increase in output per hour to increase at an average rate of 3.6 percent between 2000 and 2003. That rate is well above that observed between 1996 and 2000. DRI's November Control forecast calls for real GDP growth at a 3.6 percent annual rate in 2001, followed by growth at 4.3 percent and 4.8 percent rates in 2002 and 2003. DRI's forecast for 2001 is above the Blue Chip Consensus of 3.4 percent. Their outlook for 2002 and 2003 is well above the Blue Chip Consensus forecasts of 3.3 percent and 3.2 percent. Indeed, their outlook for 2002 and 2003 is significantly above the average forecast of the ten most optimistic Blue Chip panelists.

DRI Sets Real GDP Growth at 4.3 Percent in 2002, 4.8 Percent in 2003



Minnesota's Council of Economic Advisors does not consider a recession likely in the short term. The Council and Finance Department economists believe the 25 percent probability DRI assigns to a scenario containing a recession midway through 2001 significantly overstates the risk of a near term recession. Both noted, however, that there is substantial downside risk to the current forecast. DRI is projecting a continuation of very strong real growth. That leaves room for economic growth to slow significantly

without creating a recession. The Finance Department cautioned that revenues can fall substantially below forecast even without a recession.

No member of Minnesota's Council of Economic Advisors was as optimistic as the DRI Control for 2002 or for 2003. Council members did not consider it impossible for the economy to grow at the rates projected by DRI, but all felt uneasy making a forecast calling for real, inflation adjusted, growth in excess of 4 percent two and three years into the future. For the Control scenario to hold, the productivity changes observed in the past few years must continue at a high level. Council members admitted being more comfortable with a projection of slightly slower growth when the forecast horizon is as long as required in this revenue forecast.

The Finance Department noted that few national forecasters, other than the major forecasting services offer a forecast for 2002 or 2003, and pointed out that the Blue Chip Long-Range Consensus projections carried the warning, "APPLY THESE TREND PROJECTIONS CAREFULLY. Most economic and political forces cannot be evaluated over such a long time-span."

Some Council members were also concerned about DRI's assumptions about future oil prices, questioning whether crude oil prices would fall as rapidly as anticipated in the Control scenario. Council members and Finance Department economists were less concerned about the inflationary impact of higher fuel prices than about their potential impact on consumer demand. Should oil prices stay at current levels the cost of home heating will exceed projections. That will cause discretionary household income and spending on non-fuel items to fall below forecast. DRI assigns a 20 percent probability to a scenario that has crude oil prices remaining near the \$30 per barrel level through early 2003. That assumption reduces the projected real GDP growth rate by about one-half of one percentage point per year. Under the Control forecast, oil prices remain at \$28 per barrel until next spring, then fall to the \$24 per barrel range.

Consistent with their outlook for oil prices, DRI expects inflation to remain well under control through the forecast horizon. The Control projects the CPI to grow by only 1.7 percent (fourth quarter over fourth quarter) in 2001 and 2002. Council members and the Finance Department also expect inflation to remain under control, but their individual forecasts were slightly less optimistic, anticipating CPI growth of roughly 2.5 percent per year through 2003. The Council judged DRI's projected CPI growth of 2.4 percent in 2004 and 2.7 percent in 2005 to be reasonable. The Finance Department noted that DRI's inflation assumptions provide some slight protection against an overly optimistic forecast for real growth.

For the first time since February 1995, the Council formally considered replacing the DRI Control Forecast with a more conservative forecast. Despite unanimous concerns about the optimism of the November Control, after a lengthy discussion a majority of the Council recommended that the Department of Finance base its November revenue forecast on DRI's November Control forecast.

One Council member noted that while the forecast was noticeably higher than his own personal forecast, it was not outside the confidence bands established for his model. Others, while uneasy with the forecast of extremely strong growth for the next three years, were uncertain what specific changes would be needed to bring the forecast closer to the consensus. Everyone agreed that the productivity assumptions were the key, but the absence of a strong theoretical backdrop for dealing with productivity would cause any adjustments to be based on impressionistic evidence and intuition.

Council members and the Finance Department emphasized that the optimistic nature of this forecast greatly increases the risk that revenues will fall short of forecast at some point in the 2002-03 biennium. Productivity growth rates have been very volatile historically, with periods showing relatively high growth in output per hours followed by periods of more modest growth. If productivity growth fails to increase further over the next two years, state revenue collections will not meet projections. The Council urged the Governor and the Legislature to seriously consider the likelihood of a potential revenue shortfall in 2002 or early 2003 in their budget planning for the coming biennium. Providing a further increase in the state's budget reserve was considered a prudent action. The Council re-iterated its belief that a budget reserve of 5 percent of biennial general fund spending was appropriate.

The Council was also asked to review the advisability of changing the base economic forecast used in preparing the 5 year revenue planning estimates. Currently the Finance Department bases those estimates on a hybrid forecast created by combining real growth rates from the 25 year cycle-long forecast with inflation estimates taken from the current Control. One alternative is to base the long term estimates on the year four and year five nominal growth estimates in the Control. The current base is considered to be more stable, but to have a slight conservative bias. The Control alternative is simpler and more easily understood, but is considered to have an optimistic bias.

After consideration the Council recommended that the Finance Department continue using projections less optimistic than Control. Council members preferred a methodology with a slight conservative bias to use of the Control forecast estimates which have a slight positive bias. The Council suggested that the issue be re-evaluated again in two years, at the time the first planning estimates for the 2006-07 biennium are prepared.

Economic Outlook

Satisfied with signs of slowing, the Federal Reserve has not raised interest rates since last May. Most economists believe the Fed has maneuvered the economy to a soft landing of low unemployment and stable inflation. It is unclear how long the economy will remain on its present course.

Despite its success, the Fed remains on an inflation watch. Third quarter real GDP growth slowed, but consumer spending did not, raising the possibility that interest rates may not be high enough. Higher rates may also be needed if energy costs or rising wages begin to fuel inflation. Even as it sits on the sideline, the Fed is still in the game. Interest rate increases engineered by the Fed during the year ending last May will be working their way through the economy until next summer, interacting with unexpected events for better or for worse.

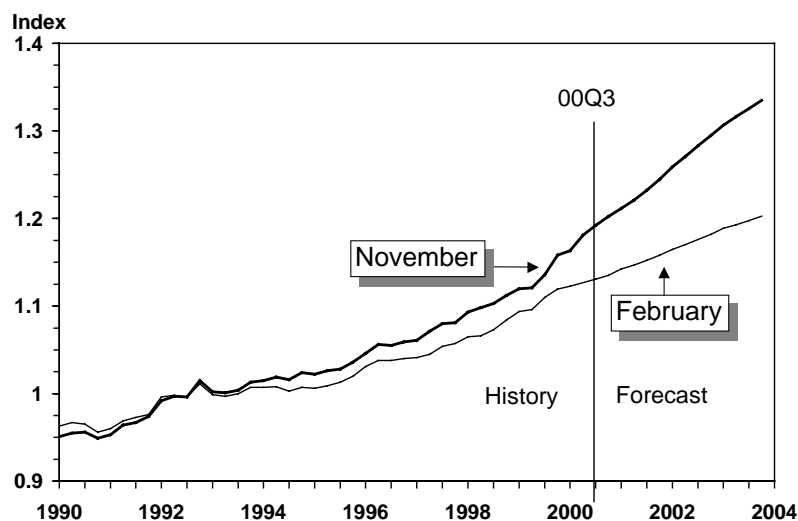
Surprising recent productivity gains could strengthen the economy's resilience following future shocks. For the year ending in third quarter, 2000, output per hour in nonfarm business rose 5.0 percent, almost double the average annual increase of the previous two years, and more than three times annual growth between 1976 and 1997.

Economists cannot fully explain why productivity growth accelerated. If strong gains continue, they will help the expansion survive because the economy can grow faster without rising inflation, and because the risk of a retrenchment in consumer spending is reduced. More output per hour raises potential real GDP, so surges in demand can be met without shortages. At the same time, firms experience unit cost savings which let them pay higher wages in tight labor markets without raising prices. With wages driving real income growth, consumer spending is less likely to falter because of stock market weakness, higher energy prices, or other bad news. Consequently, productivity has recently become a much more important variable in economic forecasts, including DRI's.

Productivity Raises DRI Forecast

DRI now believes potential real GDP is growing at a robust 3.9 percent annually in the long term, up from just 2.8 percent a few years ago. Two thirds of that 1.1 percentage point increase, a change of almost 40 percent, comes from productivity gains. Some 0.2 percentage point is attributable to investment in labor saving equipment. Put simply, workers can produce more with more and better tools, a phenomenon economists call capital deepening. Given the strength of business investment in recent years, growth in potential output attributable to capital deepening is no surprise. The surprise is that another 0.5 percentage point of additional growth in potential capacity represents more efficiency gained from unknown sources, which economists call multi-factor productivity, or MFP.

Output Per Hour In Nonfarm Business



Following an upward revision to historical data, and recent gains, DRI has sharply raised its forecast for output per hour. Scarce workers are now expected to produce more, raising average annual potential real GDP growth some 40 percent compared to a few years ago. In the November Control, strong demand fills that capacity, making DRI much more optimistic than in February.

Despite uncertain origins, MFP's importance is hard to overstate. Its contributions to output are large over the long term. For example, a recent National Bureau of Economic Research (NBER) study shows MFP is responsible for 52 percent of growth in real GDP per capita in the private business economy between 1948 and 1996. If recent trends continue, it seems MFP may become even more important to improvements in economic well being as measured by GDP.

DRI's MFP estimates are based on their analysis of the U.S. economy, and on revised investment spending and capital stock data released by the U.S. Department of Commerce in July. It may be that MFP increases are coming from the information technology driven "new economy" often discussed in the media, but DRI's productivity forecast is based on the revised data and on certain assumptions which are not part of a theory of MFP.

Last July, DRI began using their new model of the U.S. economy which incorporates MFP as an explicit variable. But economists do not know which industries have MFP gains, and they do not have a theory for how it is generated. Consequently, in the DRI model, MFP is a single lever adjusted by the operator. For forecasting, part of recently observed MFP increases are assumed to be short-lived. What remains raises the estimate of the economy's future potential capacity. In the November Control, strong demand fills virtually all that capacity, making DRI's forecast of future real GDP growth more optimistic than in February.

Lack of a theory means economists are unsure of just what MFP measures. Labor force and capital stock measures capture improved labor quality and technology represented by high-tech equipment and software. So, MFP represents gains in real GDP which appear costless, though technology is thought to be involved. For example, computers process more information faster, presumably leading to better decisions. However, economists also believe some MFP gains are the effects of more intense global competition. There is additional uncertainty because MFP exhibits both cyclical and trend movements. Currently, analysts have no theory explaining the separate contributions from technology and competition, and there is no clearly superior way to distinguish cycle from trend. Consequently, there is no reliable way to predict MFP.

Supply Side Sources of Stronger Real GDP Growth

In the late 1990's, U.S. economic growth unexpectedly accelerated. A recent study by Federal Reserve Board (FRB) economists concludes faster growth was made possible by contributions from an expanding capital stock and a growing labor force, and from improvements in the efficiency with which labor and capital are used. Investment in information technology capital played an important role, but since 1996 there were also surprising gains in efficiency which economists call "multi-factor productivity" or, MFP. If the 1996-1999 trends continue, the economy will be able to grow much faster than it did in the 1974-1995 period without accelerating inflation.

Contributions to Real Non-Farm Business GDP Growth, 1974-1999

	<u>1974-90</u>	<u>1991-95</u>	<u>1996-99</u>
Average Annual Growth	3.06%	2.75%	4.82%
Labor Hours	1.16	.82	1.50
Labor Quality	.22	.44	.31
Information Technology Capital	.49	.57	1.10
Other Capital	.86	.44	.75
Multi-Factor Productivity(MFP)	<u>.33</u>	<u>.48</u>	<u>1.16</u>
Total	3.06%	2.75%	4.82%

Source: Stephen D. Oliner, Daniel E. Sichel, Federal Reserve Board, May, 2000.

Despite MFP's importance, the methodology used to measure it does not have a strong theoretical foundation. Instead, an accounting framework assigns nonfarm private sector real GDP growth to its proximate causes. The FRB study is typical in taking those causes to be labor, capital, and MFP. Economists estimate MFP indirectly by calculating how much of real GDP growth is coming from additional worker hours and additions to capital stock. The remainder is attributed to the unexplained residual called MFP.

Is Faster Growth Sustainable?

Many observers assert there is a "new speed limit," but no one knows for sure that faster growth is sustainable without accelerating inflation. Significant uncertainty exists because a broad spectrum of industries may not be experiencing MFP gains, because it is unclear exactly how MFP improvements are generated, and because no one knows how long current heavy investment in information technology can continue.

There is some evidence that productivity improvements observed in the aggregate data are concentrated in just a few industries. Northwestern University economist Robert Gordon calculates that once measurement issues are resolved and cyclical effects accounted for, most recent MFP increases occurred in durable goods manufacturing, and particularly in computer production. He finds negligible gains elsewhere in manufacturing, suggesting there are no widespread increases in MFP. If true, then many industries are not experiencing the efficiency driven unit cost savings needed to pay higher wages without raising prices. This implies that the economy may be more inflation prone than it now seems to be.

While technology is widely thought to be involved, the exact nature of MFP improvement is obscure. Economists generally agree that MFP gains mysteriously slowed after 1973, and just as mysteriously reappeared about 1996. While the latter event seems to coincide with the beginning of widespread Internet use, Brookings Institution economist Alan Blinder points out that it is unclear whether the improvement is short-lived.

A recent study by Federal Reserve Board (FRB) economists also indicates strong recent MFP improvements. But the report also indicates that capital deepening in the form of heavy investment in information technology capital during the past several years seems responsible for large direct additions to productive capacity which are independent of MFP. The contributions from technology driven capital deepening are as large as those made by MFP.

Using a slightly different methodology, DRI finds a somewhat smaller capital deepening contribution. While the magnitude of the impact is in doubt, there is no question that labor saving innovations will have to continue if still more high-tech investment is to be justified. Some economists, and particularly Dr. Gordon, contend that the current wave of innovation in digital technology is almost over.

Higher Oil Prices Could Fuel Inflation Or Slow The Expansion

Crude oil, gasoline, diesel fuel, heating oil, and natural gas prices are unexpectedly higher than a year ago because of faster world economic growth, OPEC's failure to boost crude production enough to keep prices down, lean inventories, and full capacity utilization at U.S. refineries. That, combined with increasing dependence on crude from Saddam Hussein's Iraq and rising tensions between Israelis and Palestinians, raises the possibility of an oil price shock reminiscent of the 1970s.

Even without a shock, oil prices may creep higher as the winter peak in world demand approaches. Currently, most analysts do not seem greatly concerned. Many point out that at \$35 per barrel, the real crude price is only half what it was in the early 1980s when the U.S. economy was much less energy efficient than it is now. For a recent *Business Week* article, DRI estimated that \$40 oil would shave 2001 real GDP growth by 0.6 percentage point from a 3.8 percent baseline.

However, oil much above \$40 is a different matter. Goldman-Sachs economists, DRI, and others believe oil at \$50 or more would lower consumer spending and raise inflationary expectations, leading to tighter financial market conditions. If that happens, *Business Week* points out that the Federal Reserve's task becomes much more difficult if not impossible. Once oil prices are siphoning off consumer purchasing power while spawning inflation, the Fed is in a situation it cannot control by cutting rates, or by raising them. The last time that happened was back in the 1970s.

Consumption

Despite higher interest rates, unexpectedly expensive energy, and a weak stock market, consumers continue to spend all their income, and more financed by soaring debt, particularly among low income households. In the third quarter, real consumer spending rose at a 4.5 percent annual rate, up from 3.1 percent in the previous quarter. Household spending is strong because jobs appear to be easy to get, incomes are rising, and, except for energy, inflation is low and apparently stable. DRI believes higher motor fuel, heating oil, and natural gas costs are having relatively little impact on spending because consumers think current prices are temporary. Finance Department economists think winter heating bills may force a change in outlook.

Currently, there are tentative signs of a consumer spending slowdown. Confidence has slipped slightly, possibly because of the soft stock market. Weak growth in October retail sales has raised doubts about the Christmas season. Light truck sales have declined because of higher interest rates, more expensive gasoline, a saturated market, and possibly as a consequence of a tire recall. Housing activity has cooled. Starts are down from a year ago, existing home sales have declined, and investment in new homes was off sharply in the third quarter.

Investment

During the ten years of the current expansion, real equipment spending has surged at a record rate for the post-War era. Business investment has been led by purchases of computers, software, and communications equipment. Economists attribute the boom to rapidly declining prices for high-tech products. Research by Federal Reserve Board economists identifies high-tech investment as an important proximate cause of the recent late-cycle surge in labor productivity.

A recent *Business Week* article indicates such a narrowly focused source of growth makes the economy vulnerable to a slowdown in high-tech innovation and investment.

Typically, improvements in new technologies appear more slowly as time goes on. That happened with electricity and the internal combustion engine. No one can be sure when something similar will occur in computers and telecommunications.

In the new Control forecast, DRI anticipates that technology investment growth will ease, but continue to lead real equipment spending. While high-tech prices are not falling as rapidly as they were in the mid-1990's, firms are expected to buy still more capital equipment as a substitute for scarce and increasingly expensive labor.

Government

The Congressional Budget Office (CBO) has forecast that a significant federal surplus will accumulate over the next 10 years. There are really two projected surpluses. One is in Social Security, the other is in the federal budget excluding Social Security. Over the next decade, the Social Security surplus is expected to be some \$2.4 trillion. During the same period, another \$2.2 trillion surplus is forecast to accumulate in the budget excluding Social Security. In comparison, annual nominal GDP in 2000 will amount to about \$10 trillion.

A mid-October article in *The New York Times* examines the assumptions behind the CBO revenue estimates. According to the CBO's director who is quoted by the *Times*, the forecast implies the tax structure will generate more federal revenue at any level of economic growth than it did a few years ago. The underlying assumption is that during the next ten years the stock market will continue to generate significant tax revenue from several sources including capital gains, stock options cashed in, market-related bonuses, and withdrawals from pension plans. It is also assumed the recent productivity surge will continue to boost individual incomes and company profits. A Brookings Institution economist quoted by the *Times* points out that a recession could undermine all those assumptions.

Recent news reports indicate the CBO is considering whether to raise its revenue estimates in a forecast update due next January. If that happens, it would be because the CBO raises estimated long term average annual real GDP growth over the next 10 years from 2.7 percent to 3.3 percent. While that revision would still leave the CBO's outlook less optimistic than DRI's, news reports indicate the CBO's advisory board of economists thinks 3.3 percent is too bullish.

International

Most forecasters believe the U.S. trade deficit has become unsustainable. DRI estimates the current account deficit will reach 4.3 percent of GDP this year, and 4.8 percent by 2005. No country with such a large deficit has ever succeeded in keeping the value of its currency stable. Eventually, the dollar will have to fall. The impacts on the domestic economy will be higher interest rates and possibly higher inflation.

Currency markets are already discounting a lower dollar. Foreigners are now getting an interest rate premium of about one percentage point above European returns for holding dollar denominated assets. But, the U.S. has better investment opportunities than Europe or Japan. While that continues, the dollar is unlikely to fall because foreigners will buy dollars in order to invest in the U.S.

Observers believe the flow of funds to the U.S. is a key reason for the euro's almost 30 percent decline relative to the dollar since its introduction in January, 1999. That debacle for Europe has been a boon to the U.S. which has been able to import relatively cheap goods from euro zone countries while using foreign capital to build up domestic production capacity. However, U.S. based companies operating in Europe have experienced lower profits because the declining euro increases costs of raw materials traded in dollars, and reduces the dollar value of repatriated profits.

Inflation

Despite higher energy prices, there is virtually no sign of accelerating inflation. Core inflation, which is the Consumer Price Index excluding food and energy, seems stable and DRI expects it to remain well below 2.5 percent for the next three years. Wage and fringe benefit costs have accelerated, but apparently are being offset by higher productivity. In the November Control forecast, current oil prices do not persist long enough to force up inflationary expectations or the prices of other goods and services. By midsummer, crude oil prices are expected to be sliding downward.

Crude prices are expected to decline because newly discovered oil costing around \$20 per barrel should eventually enter the market. However, in the view of Finance Department economists, declining crude prices may not necessarily lead to lower prices at the pump because U.S. refineries are working at capacity just keeping up with current demand.

Monetary

Weaker employment reports, tentative signs of a slowdown in consumer spending, a declining stock market and other signs of softening have apparently convinced the Federal Reserve that no further tightening is needed at the present time. DRI indicates that signs of a slowdown first appeared as expected almost exactly one year after the interest rate increase in June, 1999.

But, no one believes the Fed will be able to remain on the sideline indefinitely. Even if an unexpected shock does not push the economy off course, resolution of some significant issues could lead to shifts in monetary policy. In public statements, Chairman Greenspan has indicated that it appears as though recent productivity growth has been driven by technological advances. If true, then he must grapple with problems economists do not understand very well. To Finance Department economists, it seems as though there are new uncertainties associated with the "new economy."

Some analysts believe technology driven productivity gains are concentrated in just a few industries. If so, productivity improvements are not offsetting labor cost increases in large parts of the economy, making inflation more likely than it now seems to be. However, measures of output in many non-manufacturing sectors may be so inaccurate economists cannot be sure productivity gains are narrowly based. That could force Dr. Greenspan to make decisions without much help from the volumes of data he is renowned for sifting.

A technology driven economy could pose other possibly more fundamental challenges with economic theory offering limited guidance. A recent *Wall Street Journal* article indicates the Fed should change its focus if the economy is truly on a fairly stable, non-inflationary path dominated by technology driven growth in potential output. Rather than targeting short-term movements in inflation indicators as it presumably has in the past, the Fed should seek to establish interest rates which are optimal for long term growth. However, apparently there is little recent research on how such interest rate targets might be established. The *Journal* notes that in recent public statements, Dr. Greenspan appears to be indicating he is drawing on the writings of the early 20th century Swedish economist Knut Wicksell for guidance.

Minnesota Outlook

Minnesota's economy is expected to continue its strong performance of recent years despite a modest slowing last summer. Moderating growth did not significantly ease tight labor markets. A Minnesota Department of Economic Security study released in late August indicates that the Twin Cities metro area has twice as many job openings as unemployed. And, as for the past three years, monthly unemployment rates continue to hover close to record lows.

While growth is forecast to be slower than in the recent past, most indications are strongly positive. Minnesota's manufacturing sector is expected to perform much better than its national counterpart. One reason appears to be international trade. A report recently released by Minnesota's Department of Trade and Economic Development shows that the state led the nation in growth of manufactured exports in 1999. Elsewhere in the state economy, a broad base of strength is indicated by rapidly rising total wages paid in most sectors.

A few sectors are experiencing serious difficulties which are expected to continue. Agricultural prices remain very low. The paper and wood products industries are suffering from foreign competition, nationwide overcapacity, and low prices. And a large taconite plant is scheduled to be closed next summer. Those circumstances are reflected in November's outlook.

Forecast Based on Incomplete and Preliminary Data

As in every forecast, incomplete and preliminary data for the recent past forms the critically important jumping off point for the 2001-2003 outlook. Finance Department economists believe the preliminary U.S. Department of Commerce estimate of first quarter 2000 Minnesota total wages is too low. Economists at Commerce will not comment except to say that they will be unable to provide a revision until April. Consequently, data from the Minnesota Department of Economic Security was used to estimate first quarter wages. Second and third quarter wages were estimated using the Finance Department model of the Minnesota economy adjusted where needed to reconcile with income tax withholding collections. Fourth quarter wages were estimated solely by the model.

Outlook Improves

Stronger than anticipated U.S. economic growth and upward revisions in DRI's November Control forecast are reflected in a higher forecast for Minnesota wages. In contrast, the employment projection remains close to last February's, primarily because the statewide labor market appears too tight to respond normally to strong demand.

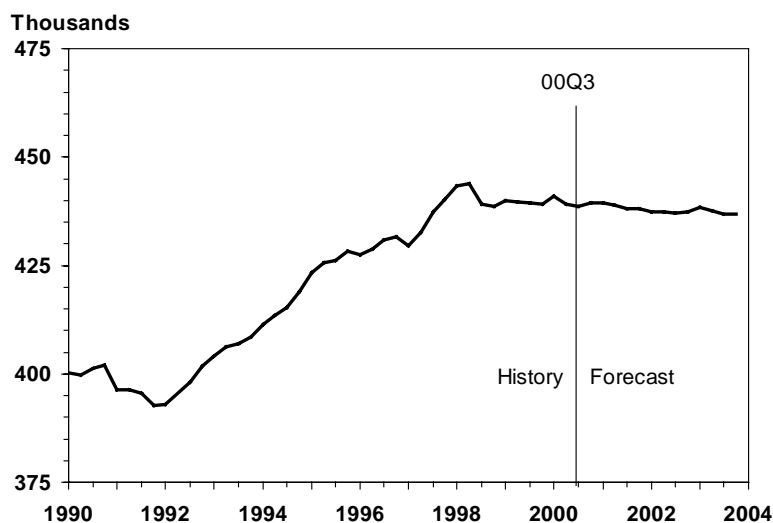
Minnesota's economy appears to have performed better than its national counterpart in 2000. Total Minnesota wages are now expected to rise by 7.7 percent in 2000, up from 6.1 percent forecast last February. Preliminary data for the first three quarters of 2000

now indicate that Minnesota nonfarm employment will rise 1.8 percent this year, up from 1.6 percent in February's forecast. In comparison, estimated total U.S. wages increase 6.6 percent in 2000, up from 6.4 percent. U.S. employment rises 2.1 percent, up slightly from 2.0 percent previously.

The November forecast for 2001-2002 indicates the Minnesota economy will continue performing better than the national average. In 2001, total Minnesota wages are now expected to rise 6.6 percent, up from 5.1 percent in February. Minnesota jobs are expected to grow 1.2 percent, the same as in February. The national economy is not expected to do quite as well. Total U.S. wages are forecast to grow 6.0 percent in 2001, up from 5.4 percent in February. Jobs are expected to grow 1.1 percent, down from 1.2 percent previously.

In 2002, Minnesota wages are expected to grow 6.3 percent while rising 6.0 percent nationally. Jobs in Minnesota should increase 1.3 percent, slightly better than the 1.2 percent expected for the U.S.

Minnesota Manufacturing Employment



In the November forecast, Minnesota manufacturing employment is expected to continue a slow decline. That performance should be much better than in manufacturing nationally, where DRI expects 900,000 jobs will be lost.

Manufacturing Outlook A Critical Part of the Forecast

For the past several years, Minnesota's manufacturing sector has performed better than its national counterpart. Between 1992 and 2000, Finance Department economists estimate the state's manufacturing sector added about 42,000 jobs, a 9.7 percent increase. During the same period, U.S. manufacturing added 337,000 jobs, growth of 1.9 percent.

In the November Control, DRI forecasts a sharp decline for U.S. manufacturing amounting to a loss of more than 900,000 jobs through 2003, or about 5.0 percent of the

workforce. Nothing like those dismal conditions is expected for Minnesota which should lose only about 2000 manufacturing jobs, or 0.5 percent, in a slow decline. That occurs primarily because current weakness in the computer and paper industries is expected to continue.

Despite fewer jobs, wages paid by Minnesota's manufacturing sector are expected to rise and make a significant contribution to the state economy. Through 2003, manufacturing, with 16.5 percent of total employment, is forecast to contribute 16.4 percent of the growth in total wages paid.

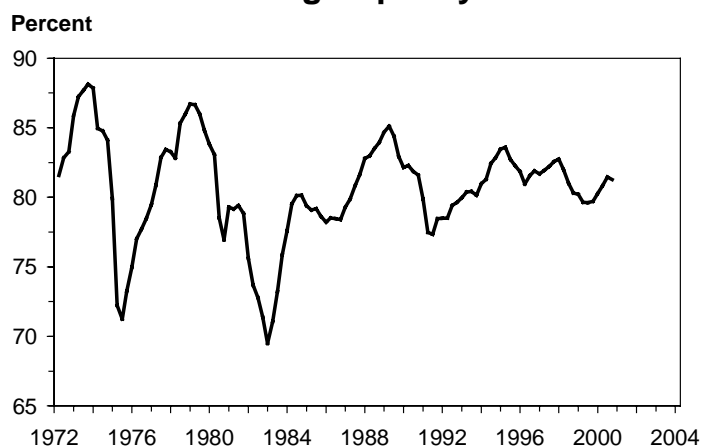
New Estimates of Personal Income

Revised Minnesota personal income estimates are significantly higher in history and in forecast. That is true of both the levels of personal income and the growth rates. While some of the change in the forecast reflects higher wages in a strong economy, the upward revision to the historical data is the result of a new U.S. Department of Commerce methodology for calculating personal income.

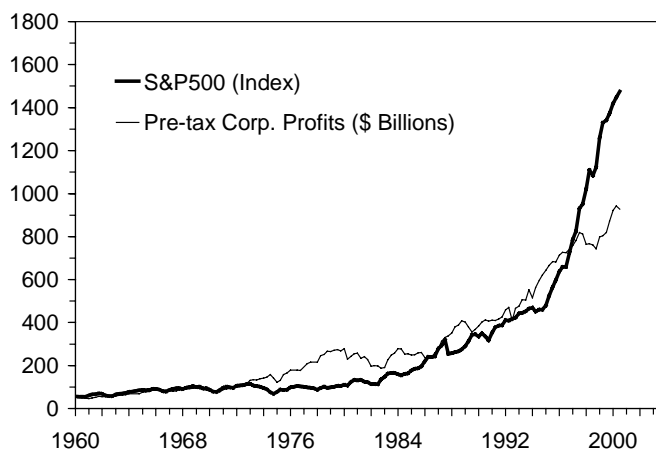
According to the June issue of the *Survey of Current Business*, Minnesota was one of three states where the new methodology resulted in a significant upward revision to dividends, interest, and rent. That change had a disproportionately larger impact on Minnesota personal income than on the counterpart national data. This makes Minnesota look better than previously, but does not change reality.

Selected National Economic Indicators

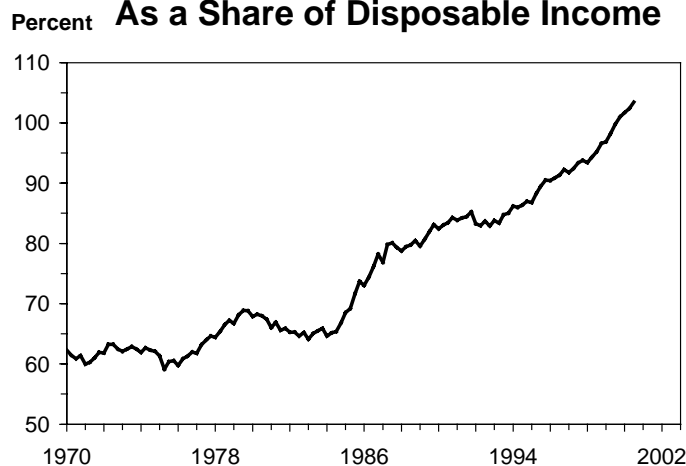
Manufacturing Capacity Utilization



Corporate Profits and the Stock Market

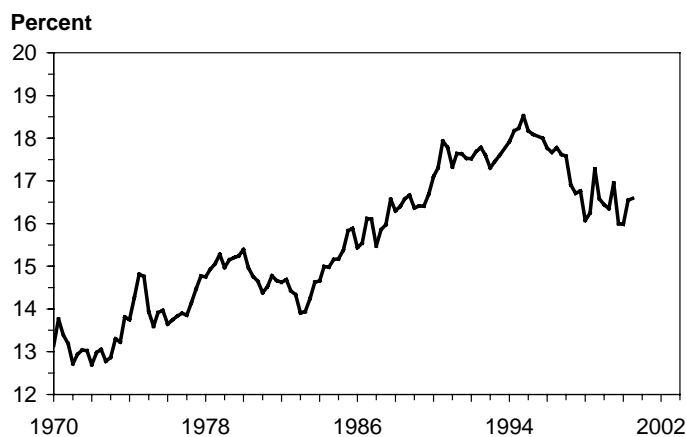


Household Financial Liabilities As a Share of Disposable Income

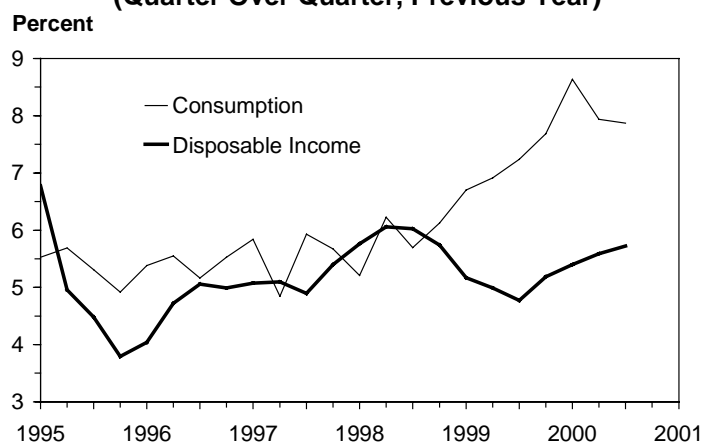


Selected National Economic Indicators

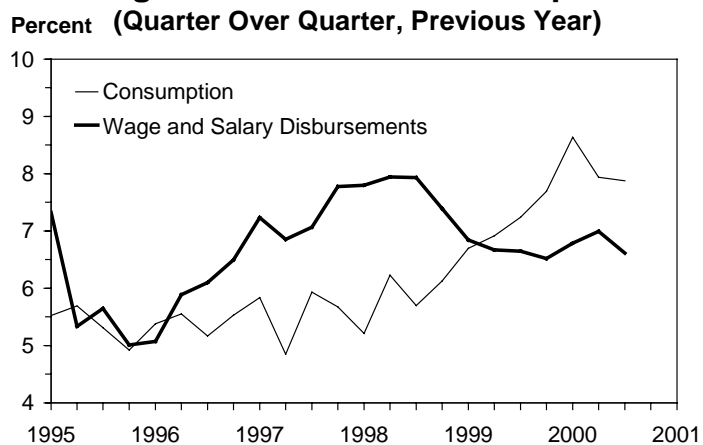
Household Financial Liabilities As a Share of Net Worth



Disposable Income & Consumption (Quarter Over Quarter, Previous Year)

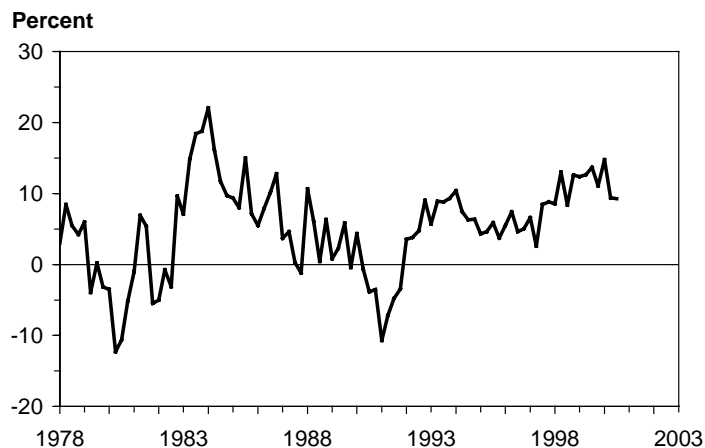


Wages & Salaries & Consumption

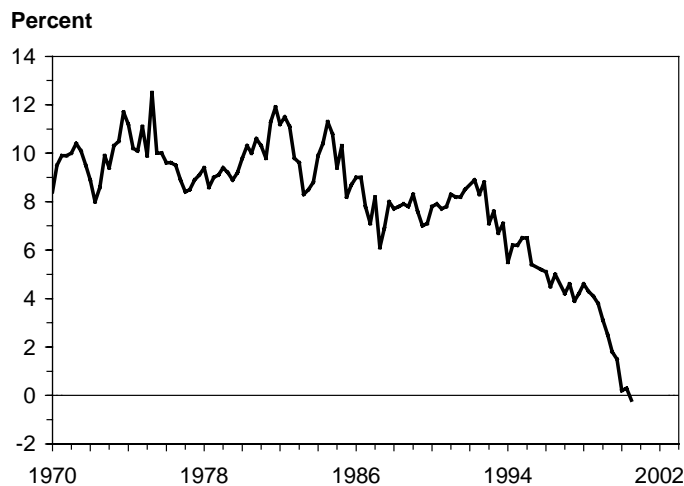


Selected National Economic Indicators

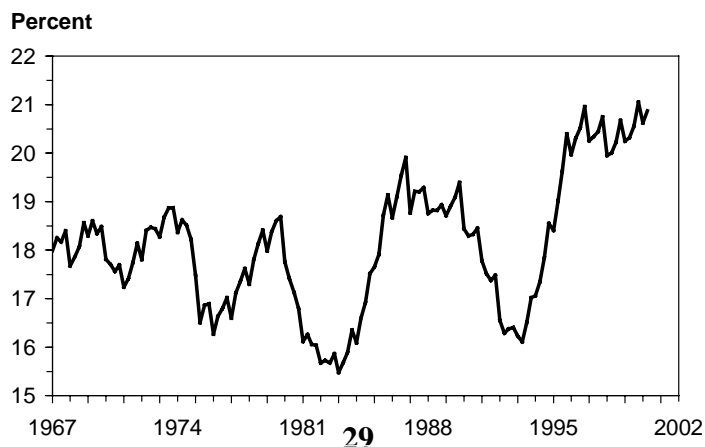
Growth in Real Consumer Durables Spending



Saving as a Fraction of Disposable Income

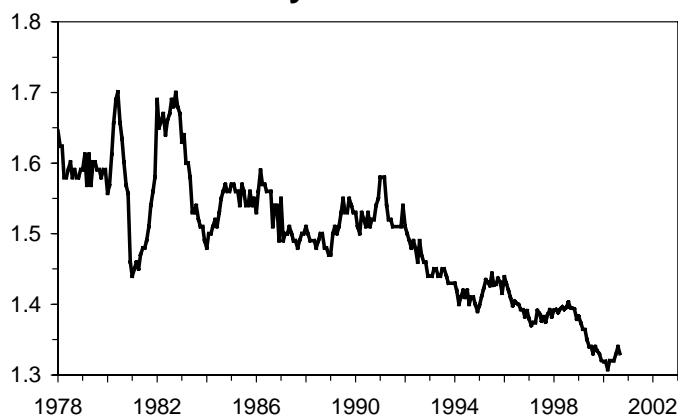


Installment Credit Outstanding As a Percent of Disposable Income

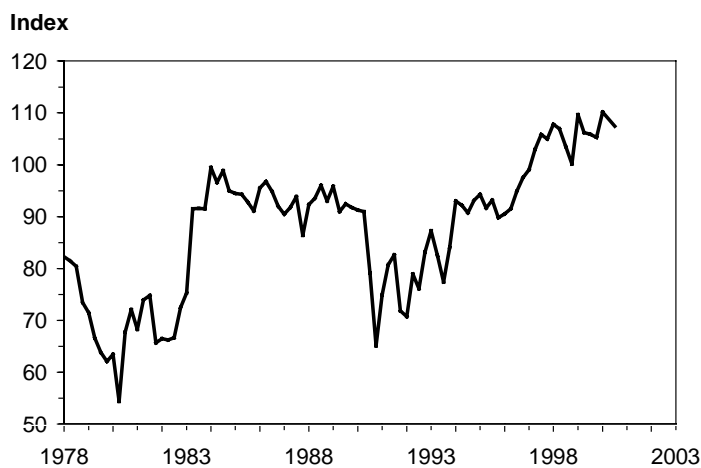


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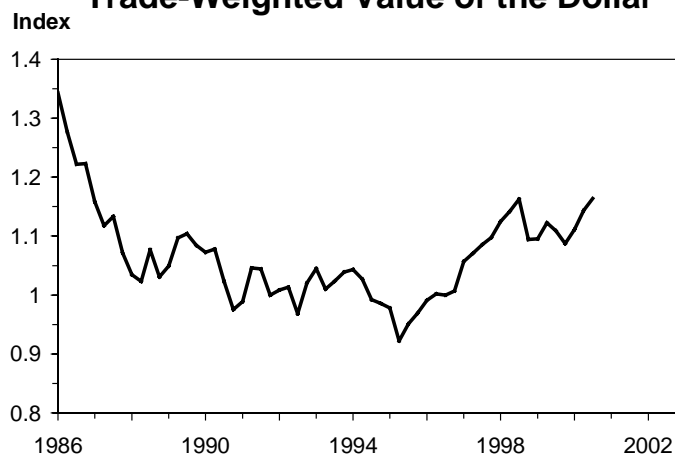
**Manufacturing and Trade
Inventory to Sales Ratio**



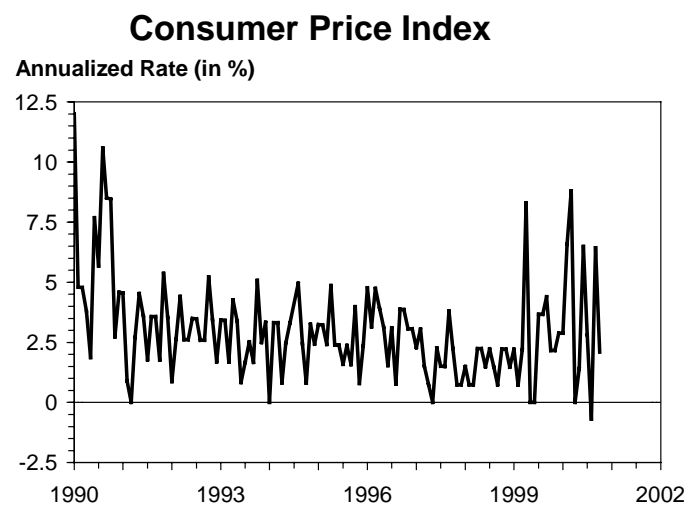
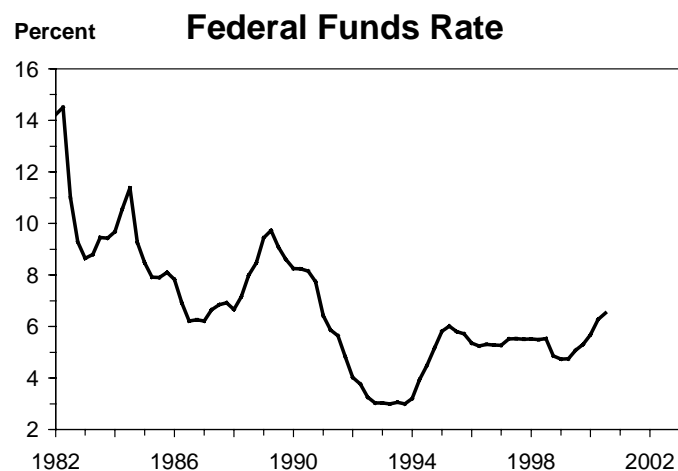
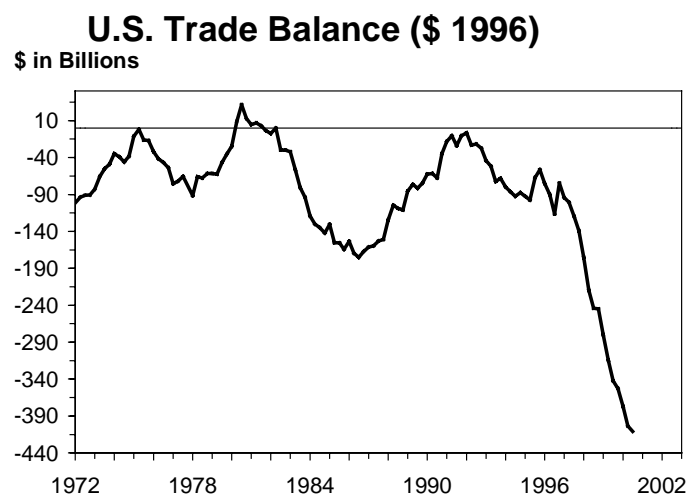
Index of Consumer Sentiment



Trade-Weighted Value of the Dollar

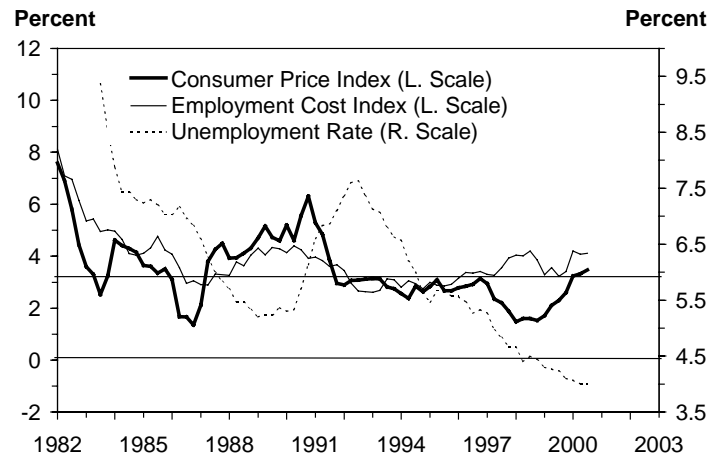


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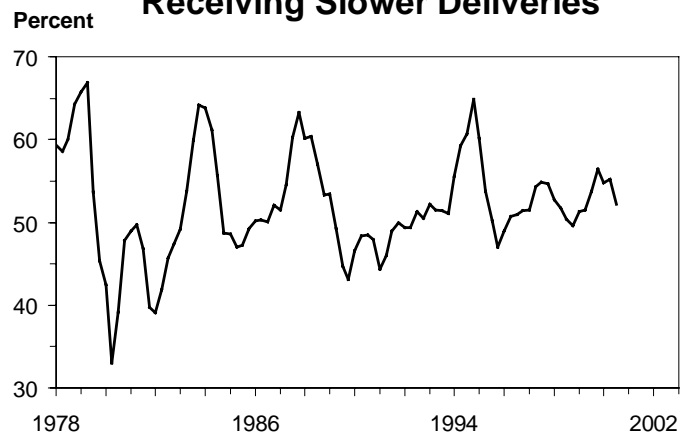


Selected National Economic Indicators

Inflation and Unemployment



Proportion of Companies Receiving Slower Deliveries



FY 2000-01 Budget Status

Revenues, transfers and other resources for the current biennium are now expected to be \$24.710 billion. This is an increase of \$865 million (3.6 percent) from estimates at the end of the 2000 legislative session. State expenditures for FY 2000-01 are now expected to be \$24.599 billion, a net reduction of \$41 million from prior estimates.

Combined with a \$9 million reduction in dedicated reserves, the forecast changes result in a \$915 million improvement in the forecast -- increasing the balance expected for the end of the biennium to \$924 million.

FY 2000-01 Forecast

(\$ in millions)

	<u>End of Session</u>	<u>November Forecast</u>	<u>Change</u>	<u>Pct.</u>
Beginning Balance	\$1,921	\$1,921	\$ 0	0
Resources				
Income Tax	11,036	11,441	405	3.7
Sales Tax	6,910	7,059	149	2.2
Corporate Income Tax	1,482	1,662	180	12.2
Motor Vehicle Sales Tax	1,055	1,077	22	2.1
Tobacco Settlement	222	220	(2)	(1.0)
Other Revenues	2,323	2,438	116	4.9
Other Resources	<u>817</u>	<u>812</u>	<u>(5)</u>	<u>(0.6)</u>
Subtotal Current Resources	23,845	24,710	865	3.6
 Total Resources	 25,766	 26,631	 865	 3.4
Spending				
Education/Children and Families	8,282	8,298	16	0.2
Health Care	3,753	3,698	(55)	(1.5)
All Other	<u>12,605</u>	<u>12,603</u>	<u>(2)</u>	<u>0.0</u>
Total Spending	24,640	24,599	(41)	(0.2)
 Cash Flow Account	 350	 350	 0	
Budget Reserve	622	622	0	
Dedicated Reserves	<u>145</u>	<u>136</u>	<u>(9)</u>	
Available Balance	\$ 9	\$ 924	\$915	

Minnesota Statutes provide that, if the general forecast balance exceeds one-half of one percent of forecast biennial revenues, the entire balance shall be designated as available for a tax rebate. Statute provides that the Governor propose a plan to rebate the available balance to the 2001 legislature.

Books Closed for FY 2000 -- Contributing \$329 Million of the Forecast Surplus

Fiscal year 2000 ended with a balance of \$746 million, or \$329 million more than forecast. Revenues were \$257 million higher than forecast, expenditures were \$65 million lower, and dedicated reserves decreased by \$7 million.

Net non-dedicated revenues were \$261 million higher than forecast with individual income tax collections contributing \$103 million of the total. Corporate income tax collections were \$58 million above forecast, sales tax collections were \$40 million higher, and motor vehicle sales taxes were \$11 million above forecast. Investment income was \$18 million above the amount previously projected.

Expenditures actually decreased \$335 million for FY 2000. However, \$270 million of this reduction represents appropriations carried forward to FY 2001 and are available for spending in that year. The remaining decrease in expenditures is due to capital project appropriations of \$63 million and agricultural assistance of \$18 million being moved from FY 2000 to FY 2001.

Revenue Forecast FY 2000-01

Current general fund resources for the 2000-01 biennium are now forecast to total \$24.710 billion, up \$865 million (3.6 percent), from end-of-session estimates. The forecast for net non-dedicated revenues increased by \$869 million (3.8 percent) to \$23.898 billion. About 40 percent of the FY 2000-01 surplus is from revenues already collected. The remaining 60 percent will come from revenues forecast to be collected through June 30, 2001.

Revenues from the four major taxes are expected to exceed end-of-session estimates by \$756 million or 3.8 percent. Expected corporate tax receipts are up by \$180 million (12 percent), while the individual income tax, sales tax, and motor vehicle sales tax were up by 3.7 percent, 2.2 percent, and 2.1 percent respectively. The large change in corporate income tax receipts was due to another reversal in DRI's outlook for corporate profits. Their February 2000 Control forecast projected a substantial drop in corporate profits in 2000 and 2001 from the levels forecast in November, 1999. In this forecast corporate profits are expected to increase significantly in both 2000 and 2001.

Other tax and non-tax revenues are now projected to be \$116 million above end-of-session estimates. Investment income increased by \$78 million over previous projections. Tobacco settlement revenues are forecast to fall short of February's estimate by \$2 million.

FY 2000-01 Revenue Forecast (\$ in millions)

	<u>FY 1998-99</u>	<u>FY 2000</u>	<u>FY 2001</u>	<u>FY 2000-01</u>
Revenues				
Individual Income Tax	\$10,067	\$5,556	\$5,885	\$11,441
Sales Tax	5,392	3,120	3,939	7,059
Corporate Tax	1,530	800	862	1,662
Motor Vehicle Sales Tax	<u>932</u>	<u>541</u>	<u>536</u>	<u>1,077</u>
Four Major Taxes	17,921	10,018	11,222	21,240
Other Revenues	2,205	1,135	1,303	2,438
Tobacco Settlement	<u>0</u>	<u>105</u>	<u>115</u>	<u>220</u>
Net Non-dedicated Revenue	20,126	11,258	12,639	23,898
Other Resources	<u>993</u>	<u>423</u>	<u>390</u>	<u>812</u>
Current Resources	\$21,119	\$11,681	\$13,029	\$24,710

Net non dedicated revenues for the 2000-01 biennium are now projected to grow by 18.7 percent over 1998-99 levels, without adjusting for the property tax rebates approved for tax years 1998 and 1999, and the sales tax rebates approved for fiscal years 1999 and 2000. Income tax collections for the 2000-01 biennium are now projected to be 13.6 percent above collections in the prior biennium. There have been two income tax rebate reductions since 1998. Sales tax collections, after adjusting for the FY 1999 and FY 2000 sales tax rebates, grew by 15.3 percent over the prior biennium.

Individual Income Tax

Individual income tax receipts are forecast to total \$11.441 billion in the 2000-01 biennium, up 3.7 percent from end-of-session estimates. Fiscal 2000 closed with an income tax variance of \$103 million. Fiscal 2001 revenues are now expected to exceed end-of-session estimates by \$302 million.

Projected growth rates for all income sources other than wages changed from February's forecast, but those changes were small. Most of the additional income tax revenue generated in this forecast can be attributed to stronger than anticipated wage growth. Tax year 2000 wage growth has been increased to 7.7 percent to reflect more recent data and observed growth in withholding. Wages are now expected to grow by 6.6 percent in 2001. February's income tax forecast was based on projected wage growth rates of 6.1 percent and 5.1 percent. That increase in aggregate wage and salary disbursements coupled with a forecast of smaller increases in payroll employment means that the average wage per job will increase more rapidly than previously forecast. For some taxpayers a portion of their additional income will be taxed at a higher rate, yielding further growth in revenues.

This is the first use of the current version of the H.I.T.S. model. This updated model corrects for a problem identified last February in the calculation of future alternative minimum tax collections, making an off-model adjustment unnecessary. It is also the first forecast prepared based on a sample of tax year 1998 filers. The H.I.T.S. model was calibrated to match projected final 1999 Minnesota liability using preliminary federal data on the composition of tax year 1999 incomes. The average projected liability on outstanding returns was set at a higher than normal level to be consistent with currently collected tax year 1999 liabilities.

The Department of Finance's income tax withholding model was adjusted to account for the income tax cut approved during the 2000 legislative session. In addition that model was expanded to take explicit account of withholding on distributions from major public pensions.

Adoption of the 1998 sample introduced a set of large, one-time capital gains realizations caused by merger and acquisition activity into the tax base. No attempt was made to remove those gains from the sample during the calibration of the model since, as noted in February's forecast, transactions of a similar magnitude also appear to have occurred during tax year 1999. For tax year 2000 and beyond, however, the H.I.T.S. model growth

factors for capital gains realizations were reduced to reflect growth from a realizations base which would not include extra-ordinary gains.

Capital gains were assumed to grow at an underlying rate of 7.6 percent in 2000, and 5.4 percent in 2001, after adjusting for the large one-time 1998 and 1999 gains noted above. This year's unsettled and highly volatile stock market following several years of substantial gains adds considerably to the normally high uncertainty attached to forecasts of net capital gains realizations.

Sales Tax

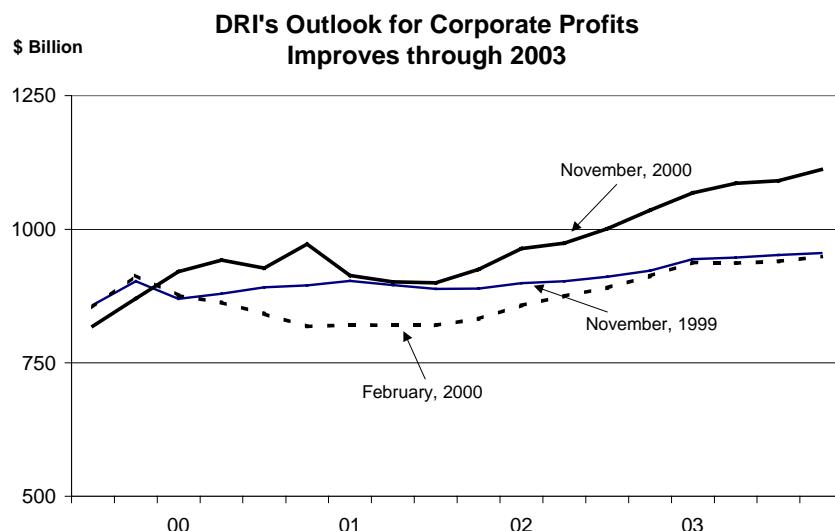
Net sales tax collections for the 2000-01 biennium are now expected to reach \$7.059 billion, \$149 million (2.0 percent) more than end-of-session estimates. The forecast for gross sales tax receipts increased by \$149 million, while sales tax refunds are now expected to be \$8 million less than February's forecast. Sales tax rebate payments are \$8 million less than end-of-session estimates. Minnesota's net sales tax receipts exceeded the forecast by \$40 million at the close of fiscal 2000. Through October fiscal year 2000 net receipts are \$6 million less than forecast.

Both capital equipment spending and consumer durable spending grew more rapidly than anticipated during fiscal 2000 increasing the base for future revenue growth. That strong growth is projected to continue through fiscal 2001, consistent with DRI's November Control forecast. Capital equipment spending is now assumed to grow by more than 14 percent this fiscal year, about twice the growth rate assumed in February.

The receipts elasticity used to convert the simulated tax base to gross revenues was continued at .975 to adjust for the current sales tax model's history of over-estimating in recent quarters. The 2000 sales tax rebate was assumed to have added \$12 million, one-time to FY 2001 collections. No explicit adjustment was made for growth in internet sales over the forecast horizon.

Corporate Franchise Tax

Net corporate tax receipts for the 2000-01 biennium are now estimated to total \$1.662 billion, \$180 million (12.2 percent) more than end-of-session estimates. This extremely large increase was almost entirely due to a change in DRI's outlook for corporate profits. February's Control forecast called for corporate profits in 2000 to hold steady at 1999's level. DRI now projects profits' to grow by 14 percent in calendar year 2000. Corporate profits share of GDP is now at the highest levels since the late 1970s. The corporate income tax remains the most volatile of Minnesota's major taxes.



Motor Vehicle Sales Tax

The sales tax on motor vehicles is now projected to yield \$1.077 billion during the 2000-01 biennium, \$22 million (2.1 percent) more than end-of-session estimates. Fiscal 2000 closed with a positive variance of \$11 million. Fiscal year 2001 collections through October were \$4 million above forecast. DRI's November Control expects slightly stronger growth in light vehicle sales for the remainder of fiscal year 2001 than was projected in February.

Other Revenues

Other tax and non-tax revenues are expected to total \$2.658 billion during the current biennium, up \$113 million (4.4 percent) from end-of-session estimates. An increase in the forecast for investment income added \$78 million. Higher cash balances and higher interest rates account for the additional revenue.

The forecast for deed and mortgage tax receipts is up \$23 million reflecting the positive variance in current collections and a stronger outlook for new and used home sales. The forecast for insurance gross premiums tax receipts was raised by \$14 million. RTC collections are now forecast to be \$19 million less than end-of-session estimates due to reduction in treatment population. The forecast for tobacco settlement payments in FY2001 was reduced by \$2 million consistent with forecasts of lower domestic cigarette consumption.

Expenditure Forecast

FY 2000-01 Biennium

Forecast expenditures for the FY 2000-01 biennium total \$24.599 billion, \$41 million less than comparable estimates at the end of the 2000 legislative session. This change in total estimated spending reflects less than a 0.2 percent reduction from previous estimates.

FY 2000-01 Expenditures

(\$ in millions)

	<u>End of Session</u>	<u>November Forecast</u>	<u>Difference</u>
Education / Children & Families	\$ 8,282	\$ 8,298	\$ 16
Post-Secondary Education	2,641	2,642	1
Property Tax Aids & Credits	3,293	3,288	(5)
Other Major Local Assistance	1,169	1,165	(3)
Health Care	3,753	3,698	(55)
Family Support	431	434	3
State Operated Institutions	963	956	(7)
Legisl., Judicial, Const. Officers	602	619	17
State Agencies' Operations & Grants	2,019	1,993	(26)
Debt Service	579	567	(11)
Capital Projects	89	89	0
Transportation Projects, Tabs	570	569	(1)
Estimated Cancellations	(34)	(22)	12
Subtotal-Major Spending Categories	24,358	24,298	(60)
Dedicated Expenditures	282	301	19
Total Expenditures	\$24,640	\$24,599	\$ (41)

Offsetting a small \$16 million increase in K-12 spending, revised estimates for health care program costs are \$55 million lower accounting for the majority of the net \$41 million reduction in FY 2000-01 expenditures. While changes in estimates are shown in the table for all other major programs, none of these are significant adjustments to the forecast. Typically, these changes reflect adjustments between categories, the impact of FY 2000 closing and subsequent appropriation adjustments, transfers of funds between agencies, and changes in dedicated revenue estimates and related dedicated spending. These technical adjustments have no material impact on total estimated spending or the ending balance.

Education Spending Up \$16 Million in 2000-01, Mostly Due to Slight Increase in Pupil Estimates

Education spending is projected to total \$8.3 billion in the current biennium, up \$16 million from end-of-session estimates, primarily due to pupil-driven increases in general education estimates. Pupil estimates for FY 2000-01 have increased slightly, but enrollment is still projected to peak at just over 853,000 students this biennium, and then to decline marginally in the next biennium.

Spending in general education increased by \$26 million over end-of-session estimates, largely due to increased pupil estimates (\$13 million), higher Limited English Proficiency enrollment (\$4 million), higher private alternative program enrollment (\$3 million) and a slower than anticipated phase-out of training and experience revenue (\$3 million). Decreases in other general education programs, including a \$2 million decrease in abatement aid and a \$2 million decrease in nonpublic pupil programs, bring the overall change in the General Education program to \$22 million.

There were only marginal changes in categorical aid programs. The largest changes were a projected \$4 million decrease in the one-time training and experience revenue replacement program, and a \$3 million decrease in the Aid for Children with a Disability program, due to correcting eligibility estimates for the program.

Property Tax Aids & Credits Forecast Falls \$5 Million in Current Biennium

Property tax aids and credits expenditures for the FY 2000-01 are expected to be \$3.288 billion, a decline of \$5 million from end-of-session estimates. Most of the decline is accounted for in two areas. First, property tax refunds are expected to decline by \$11 million because these refunds are income sensitive and personal income growth has been strong. Second, a change in the treatment of two development projects, the Minnesota Minerals 21st Century Fund (\$10 million increase) and a Richfield development grant (\$5 million decrease), combine to show a net \$5 million increase in the Aids and Credits area. However, the last item is offset by a corresponding decrease in the Trade and Economic Development budget.

2000-01 Health Care Forecast Declines \$55 Million

Forecast spending for health care programs is expected to be \$3.698 billion, a decline of \$55 million from end-of-session estimates. This 1.5 percent reduction is due to lower than expected spending recorded at the close for FY 2000. Estimates for FY 2001 are virtually unchanged from end-of-session figures, increasing by \$2 million.

The lower-than-forecast spending for FY 2000-01 occurred in all health programs except the MFIP & Other Families Basic Care portion of Medical Assistance (up \$33 million) and Chemical Dependency Entitlements (up \$6 million). The most significant savings were in Medical Assistance (MA), with changes in Aged and Disabled Basic Care (down \$35 million) and Long-Term Waivers and Home Care (down \$28 million). Savings are

due to fewer beds in long term care facilities (e.g. nursing homes, ICF/MR) and lower than expected spending for services.

Family Support Spending Up \$3 Million in Current Biennium

Once again general fund spending on family support programs is virtually unchanged from end-of-session estimates, showing the impact that federal block grants have on the state general fund budget. These block grants require minimum levels of state spending, effectively ensuring that any forecast change accumulates in the TANF account, not on the state's bottom line.

The increases for the current biennium can be attributed to slightly higher caseloads in small, state-only programs—General Assistance and Minnesota Supplemental Aid.

Significant changes in Minnesota Family Investment Program (MFIP) and Child Care Assistance offset each other and have very little net impact on the General Fund. Federal matching rules for the welfare block grant—Temporary Assistance for Needy Families (TANF)—require that Minnesota must spend \$191 million on allowable activities. Since child care and MFIP cash grants are the two largest components of maintenance-of-effort (MOE), decreases in one program must be offset with increases in the other so that the state still complies with federal guidelines.

The forecast shows lower spending in Child Care Assistance in 2001 than end-of-session estimates, due to lower child care utilization rates by MFIP recipients. This lower utilization rate, coupled with unused FY 2000 federal child care funds, results in a \$27 million decline in the FY 2001 child care forecast. Due to MOE requirements, the state share for MFIP cash grants must rise to accommodate this decline in child care (as well as other changes in MOE components.) MFIP is forecast to be \$30 million higher in 2001 than end-of-session estimates.

Debt Service Estimates for Current Biennium Are \$11 Million Lower

The total estimated debt service for the 2000-01 biennium is now \$567 million. This includes a \$7 million cost attributable to cash payments necessary to satisfy the Cambridge bank judgment.

The current estimate is \$11 million lower than the end-of-session estimates. About \$7.6 million of this amount was saved from bond premiums paid by the winning bidders on the state's June and November 2000 bond sales. The bond premium amounts were not previously forecast. About \$3.5 million was saved when more bonds were sold for MnSCU capital projects than assumed in the previous forecast. This resulted in MnSCU paying this additional amount in user financing costs. While some additional savings resulted from lower interest costs on the bonds sold in June and November, and additional investment earnings -- these savings were offset by increased costs from selling about \$10 million more in bonds than previously forecast due to projects' cash flow requirements.

FY 2002-05 Outlook

FY 2002-2003 Budget Forecast

The FY 2002-03 revenue forecast is based on DRI's November 2000 Control forecast. This is the first forecast of revenues for the 2002-03 biennium, previous revenue projections were only planning estimates based on longer term trend projections. Expenditure estimates are based on current law adjusted for enrollment, caseload changes, and specific formula requirements. An adjustment of 2.0 percent per year is included for estimated inflation; this is down from 2.5 percent used in end-of-session planning estimates.

FY 2002-03 Biennial Budget Forecast

(\$ in millions)

	<u>FY 2000-01</u>	<u>FY 2002-03</u>	<u>Change</u>	<u>Pct.</u>
Beginning Balance	\$1,921	\$2,032	\$ 111	5.8
Revenues	23,898	27,848	3,950	16.5
Transfers, other	<u>812</u>	<u>363</u>	<u>(449)</u>	<u>(55.3)</u>
Subtotal-Current Resources	24,710	28,211	3,500	14.2
Total Resources	26,631	30,243	3,612	13.6
Expenditures				
Current Law Base	24,599	25,388	789	3.2%
Estimated Inflation	<u>0</u>	<u>737</u>	<u>737</u>	<u>nm</u>
Total Spending	24,599	26,125	1,526	6.2%
Balance Before Reserves	2,032	4,118	2,086	
Reserves:				
Cash Flow Account	350	350	0	
Budget Reserve	622	622	0	
Dedicated Reserves	<u>136</u>	<u>111</u>	<u>(25)</u>	
Ending Balance	\$ 924	\$3,035	\$2,111	

Current resources are projected to increase by \$3.500 billion for FY 2002-03 over the current biennium. Projected expenditures increase by \$1.526 billion, including \$737 million in estimated inflation. Significant spending increases are forecast in K-12 education (\$527 million), property tax aids and credits (\$254 million), and health care programs (\$1.049 billion); these increases are partially offset by a decline of nearly \$500 million in one-time capital expenditures for both transportation related and other projects, and \$150 million associated with a transfer for the reduction in motor vehicle license fees approved in the 2000 Session.

FY 2004-05 Planning Estimates

The planning estimates for FY 2004-05 are materially different from the short-term forecasts for the current and FY 2002-03 bienniums. Projection methods are different and the longer term projections carry a higher degree of uncertainty and an inherently larger potential range of error. This is the first set of planning estimates for the FY 2004-05 biennium.

Planning estimates for FY 2004-05 are presented to help decision makers identify longer term state finance issues. Revenue projections are based on the average long term nominal growth rate in DRI's November Early Recession (Pessim) scenario. Expenditure projections assume current laws and policies continue unchanged, and adjust for caseload and enrollment changes. The expenditure projections add estimated inflation to the current law planning estimates to reflect the potential cost of inflationary pressures on spending through the four year period.

Current law expenditures are reflected in constant dollars (FY 2001), estimated inflation is shown as a compounded number reflecting 2.0 percent per year in FY 2002-03 and 2.5 percent per year in FY 2004-05.

FY 2004-05 Long Term Planning Estimates

(\$ in millions)

	<u>FY 2002-03</u>	<u>FY 2004-05</u>	<u>Change</u>	<u>Pct.</u>
Projected Resources				
Revenues	\$27,848	\$30,908	\$3,060	11.0
Transfers, other	<u>363</u>	<u>364</u>	<u>1</u>	<u>0.0</u>
Total Resources	28,211	31,272	3,061	10.9
Projected Spending				
Current Law	25,388	26,309	921	3.6
Estimated Inflation	<u>737</u>	<u>2,026</u>	<u>1,289</u>	<u>nm</u>
Total Spending	\$26,125	\$28,335	\$2,211	8.5

Current resources are projected to increase \$3.061 billion in FY 2004-05, over the forecast for FY 2002-03. Projected expenditures increase by \$2.211 billion, including an additional \$2.026 billion in estimated inflation. Significant forecast increases over FY 2002-03 are limited to property tax aids and credits and health care, which increase 8.0 percent and 23.6 percent respectively.

These projections are not intended to predict a balanced or unbalanced budget in the future. Their purpose is to assist in determining how well ongoing expenditures will

match revenues based on trend projections of Minnesota's economy and what it will cost to maintain the same programs

The Impact of Health Care Costs on Payrolls

While health care programs, particularly long-term care for the elderly and disabled, are the fastest growing area of the state's budget, the impact of health care cost on payrolls is also significant.

The State Employee Group Insurance Program (SEGIP) administers health, dental, and other benefits on behalf of roughly 73,000 employees and retirees of Minnesota state agencies, the University of Minnesota, and quasi-state entities such as the Minnesota Historical Society. It is the largest single employer group purchaser of health benefits in Minnesota, and is often considered a bellwether for employer health care cost trends.

After experiencing very low -- even negative -- rates of health care cost increases in the mid-1990's, SEGIP's medical costs have increased over the past several years, a pattern mirrored in much of the employer health care market. Cost increases have been especially dramatic over the last two years. The state's share of costs for employee health coverage rose 23 percent in 2000, and a 19 percent increase is projected for 2001. This translates into substantial expenditure increases. The state's share of employee medical coverage costs will be approximately \$278 million in 2001, an increase of \$45 million over 2000. Employer paid medical insurance costs represent an increasing share of total employee compensation.

SEGIP is not alone in facing escalating medical care costs. A recent survey by the Hewitt Associates consulting firm reported that on average, costs paid by employers in the Twin Cities area increased 17 percent in 2000. While increases in medical costs will vary among employers, double-digit rates of increase are common, placing financial strain on the budgets of all employers.

The cost increases affect virtually all employers and are due to a variety of factors including an aging workforce, new technology, higher utilization of medical care (especially prescription drugs), and consumer and health care provider backlash to managed care. However, unlike prior years' rounds of health care cost increases, there are few signs that the high rates of medical cost increases will abate in the near future. As a result, medical insurance costs may be expected to continue to increase at double-digit rates during the next two to three years.

The Impact of Rising Costs and Declining Federal Participation

The state and federal government jointly fund a number of programs within the Department of Human Services. In many cases, the eligible costs are split based on a matching rate known as the Federal Medical Assistance Percentage (FMAP). Though the FMAP rate applies to a number of programs (adoption assistance, county-paid foster care), by far the largest is the Medical Assistance program (MA, or Medicaid).

Changes in the FMAP rate can have significant impacts on General Fund spending. In this forecast, matching rate changes increase state spending by \$79 million for FY 2002-03.

FMAP rates vary by state and change each year. The rates are calculated with a formula using the last three years' state and national per capita income. There is an 83% ceiling on the FMAP, and there is also minimum floor of 50% match to ensure at least an even split with states with high per capita incomes.

Beginning federal fiscal year 2002, Minnesota will join a growing number of states at the minimum FMAP of 50% (11 states in FFY 2002). This means that for every dollar spent on Medical Assistance, the federal government will reimburse the state with 50 cents. Currently, the state receives 51.11 cents from the federal government.

In recent years, Minnesota's growth in per capita income has outpaced income growth nationally, resulting in a declining FMAP rate. The following table shows FMAP rates and total MA program costs for select years.

<u>Federal Fiscal Year</u>	<u>FMAP %</u>	<u>Total MA Spending</u>
1990	52.74	\$ 1.476 B
1995	54.27	\$ 2.645 B
2000	51.48	\$ 3.340 B
2002	50.00	\$ 4.103 B

The combination of a falling federal match and increasing program costs helps to accelerate the growth in state health spending. If the 1995 FMAP rate were in effect in FY 2002, General Fund spending would be \$175 million less than under the current forecast.

Minnesota's FMAP rate drop from 51.11% would have been even more significant had it not been for the presence of the 50% floor. The true calculated FMAP rate without the floor would be 48.4%. Without the floor, the state would incur an additional \$119 million in the 2002-03 biennium.

Revenue Forecast FY 2002-03

Total current resources for the 2002-03 biennium are forecast to be \$28.211 billion, up \$1.625 billion, (6.1 percent) from February's revenue planning estimates adjusted for actions by the 2000 legislature. General fund receipts from the four major taxes are now projected to grow by 15.7 percent over levels forecast for the 2000-01 biennium.

FY 2002-03 Revenue Forecast (\$ in millions)

	<u>FY 2000-01</u>	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2002-03</u>
Revenues				
Individual Income Tax	\$11,441	\$6,392	\$6,901	\$13,293
Sales Tax	7,059	4,146	4,454	8,600
Corporate Tax	1,662	827	908	1,735
Motor Vehicle Sales Tax	<u>1,077</u>	<u>541</u>	<u>411</u>	<u>952</u>
Four Major Taxes	21,239	11,906	12,674	24,580
Other Revenues	2,438	1,304	1,324	2,628
Tobacco Settlement	<u>220</u>	<u>373</u>	<u>267</u>	<u>640</u>
Net Non-dedicated Revenue	23,897	13,583	14,265	27,848
Other Resources	<u>812</u>	<u>181</u>	<u>182</u>	<u>363</u>
Current Resources	\$24,710	\$13,764	\$14,447	\$28,211

Individual income tax revenues increase the most in the 2002-03 biennium, up \$1.852 billion (16.2 percent), over levels forecast for FY2000-01. Sales tax revenues are expected to increase by \$1.540 billion (21.8 percent), and corporate income taxes by \$73 million (4.4 percent). The sales tax growth is from an artificially low net sales tax base caused by the FY 2000 sales tax rebate. Without the FY 2000 rebate sales tax receipts would grow by 11.6 percent.

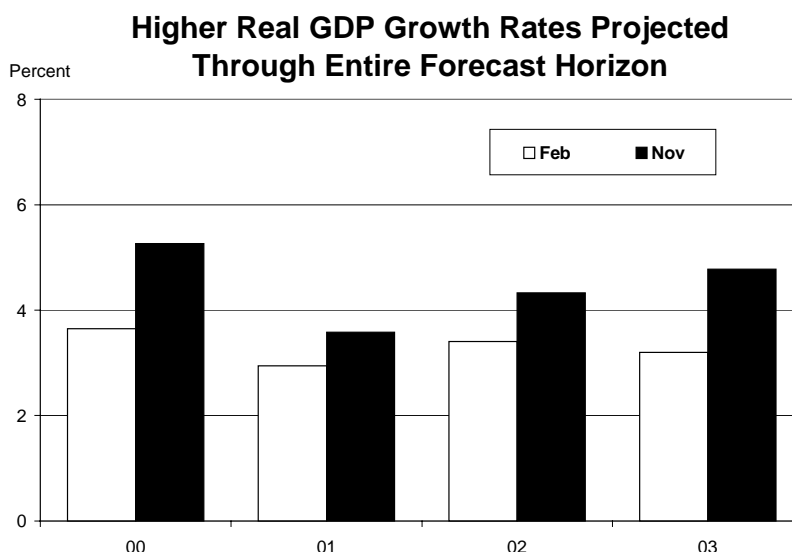
The allocation of 32 percent of FY 2003 motor vehicle sales tax revenues to the Highway User Fund causes general fund receipts to decline by \$125 million. In the absence of that transfer motor vehicle sales taxes would have grown by \$127 million or 11.8 percent.

This is the first detailed forecast of revenues for the 2002-03 biennium. Previous revenue projections for this biennium were only simple extrapolations of the 2001 revenue base, using an expected 25 year average growth rate based on DRI's cycle long forecast through 2025. Large changes between end-of-session planning estimates and the first detailed forecast for a biennium are common. Because the planning estimates cover revenues which will not begin to be received for 17 months, and since this forecast

extends until June 30, 2003, minor changes to the outlook for 2000 or 2001, or changes in the projected rate of growth for 2002 or 2003 can compound into large changes in revenues by the end of the 2002-03 biennium.

Changes in Economic Assumptions

The economic outlook used in this first detailed forecast of revenues for FY 2002-03 is more optimistic than that used as a base for February's long term planning estimates. The economic forecast for 2000 and 2001 calls for a much stronger real economic growth than was expected in February. In addition economic growth rates in 2002 and 2003 are significantly higher than projected in February. That stronger economic growth, when transferred to Minnesota's economy is the source of almost all the additional revenue for the coming biennium.

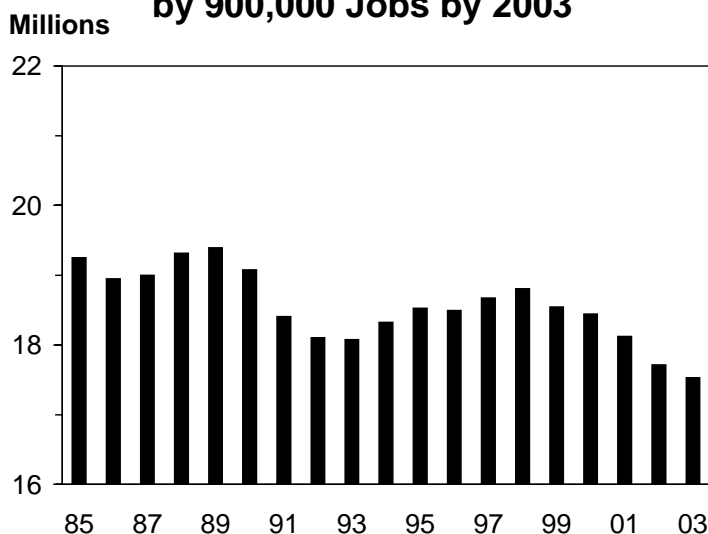


Income Tax

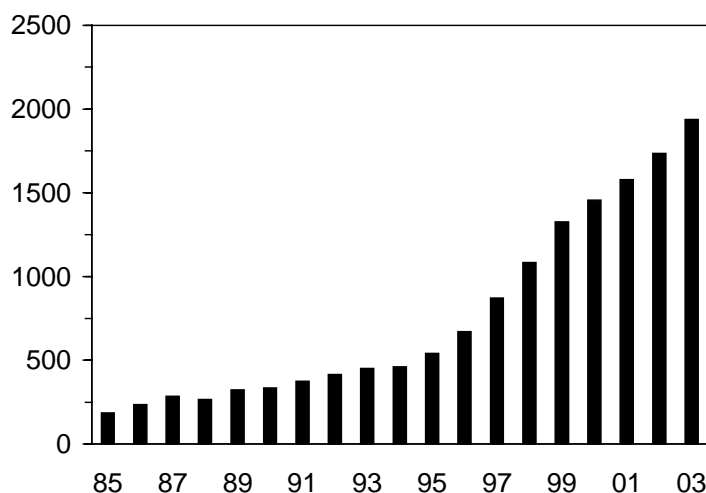
Individual income tax revenues in the 2002-03 biennium are forecast to total \$13.293 billion, up \$1.852 billion (16.2 percent) over estimates for FY2000-01 and \$833 million (6.7 percent) from end-of-session planning estimates. The chief source of the additional revenue is higher projected wage and salary growth. DRI currently expects U.S. wage and salary disbursements to grow by 6 percent in 2002 and 6.8 percent in 2003, and the Minnesota economic model projects wages and salaries in Minnesota to grow 6.3 percent and 6.8 percent respectively. The universal income growth factor used to extrapolate all sources of taxable income based on DRI's February's Control forecast was 5.1 percent in 2002. The planning estimate used to extrapolate income growth in 2003 was 4.2 percent. Those same growth factors were used to project other sources of income and deductions for calendar 2003 and 2004. Many of those income sources are also now forecast to grow more rapidly than was assumed in the planning estimates. Some of that revenue gain, however, was offset because deductions also grew faster than assumed.

DRI's November Control forecast calls for strong wage growth in 2002 and 2003, even though U.S. manufacturing employment falls an average of more than 300,000 jobs per year, from 2001 through 2003. DRI assumes a significant increase in service sector wages offsets the loss of those high wage jobs nationally. The Finance Department's model of the state economy does not project a major decline in manufacturing employment in Minnesota. In Minnesota wage growth of 6.3 percent and 6.8 percent is projected. Minnesota's current tight labor market is expected to continue through 2003, holding payroll employment growth to 1.3 percent in 2002, and 1.5 percent in 2003. The forecast of high wage growth and slow job growth implies that household incomes will continue to increase more rapidly than inflation. Under Minnesota's progressive income tax rate structure some of that additional income will be taxed at higher rates, causing an increase in the average tax rate applied.

U.S. Manufacturing Employment Shrinks by 900,000 Jobs by 2003



DRI forecasts continued strong stock market growth through 2003. By 2003 the Standard and Poors 500 average is more than 40 percent higher than its level on November 22, 2000. That stock market growth is a major factor in an increase in the value of equities held by households, a key factor in Minnesota's capital gains model. Capital gains realizations are assumed to increase at an annual rate of 5.4 percent in 2002 and 2003. If stock market growth fails to meet DRI's forecast, capital gains realizations are likely to fall short of forecast.

S & P 500 Is Up 42 Percent by 2003**Sales Tax**

Net sales tax receipts for the 2002-03 biennium are expected to reach \$8.600 billion, up 21.8 percent from levels currently projected for FY 2000-01. Fiscal 2000-01 revenues were artificially low due to the \$646 million in sales tax rebates made during the biennium. The forecast for FY 2002-03 is \$376 million (4.6 percent) more than the end-of-session planning estimate.

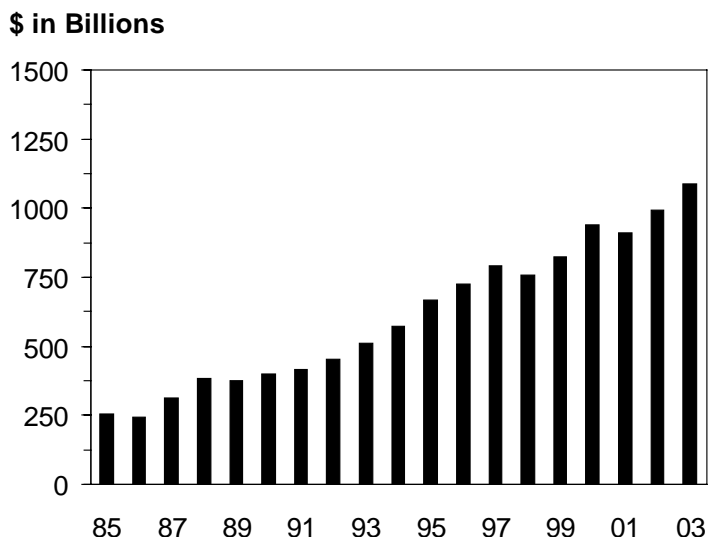
The strong wage growth projected in the November Control along with the continued increases in household wealth attributable to further growth in the stock market the provide the foundation for DRI's forecast of continued strong growth in consumer demand. Oil prices are assumed to hold in the \$22 to \$24 per barrel range in the Control forecast well below the \$30+ per barrel level observed in November. Lower oil prices release additional discretionary income to fuel DRI's forecast of continued strong consumer demand. Consumer durable spending in Minnesota is forecast to increase by 5.8 percent in fiscal 2002 and by 7.7 percent in 2003.

Projected lower interest rates in the DRI Control are expected to increase construction spending in Minnesota by 4.0 percent in fiscal 2002 and 6.5 in fiscal 2003. Nationally, housing starts in 2003 surge to levels seen only once since 1985. A one-time technical change dealing with the timing of receipts added \$11 million to the forecast for FY 2002.

Corporate Income Tax

Corporate tax revenues are forecast to total \$1.735 billion in the 2002-03 biennium, 4.4 percent more than is now forecast for 2000-01. The large change in projected corporate tax receipts for fiscal 2000-01 contained in this forecast raised the base level from which the 2002-03 forecast was made. When compared to end-of session planning estimates corporate tax revenues are projected to increase by \$260 million or 17.6 percent.

Before-Tax Corporate Profits



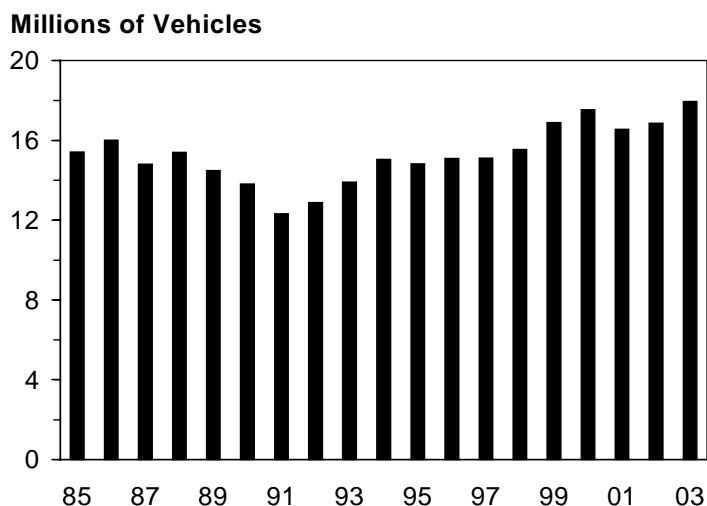
DRI forecasts that following a brief pause in 2001, corporate profits will increase by more than 9 percent in both 2002 and 2003. Corporate profits as a percent of GDP remain relatively constant, holding near their highest level relative to GDP in more than 20 years. Some of that growth is due to the change in the treatment of software costs in the national income and product accounts, but much reflects their assumption of a minor change in the distribution of returns to productivity between capital and labor.

Motor Vehicle Sales Tax

Motor vehicle sales tax revenues for the 2002-03 biennium are forecast to be \$953 million, down \$125 million from FY 2000-01 estimates due to dedication of 32 percent of 2003 collections (\$193 million) to the Highway User Fund. The full amount of motor vehicle sales tax collections increases by \$69 million (6.4 percent). The forecast for FY 2002-03 exceeds end-of-session estimates by \$46 million or 5.0 percent.

The strong economy forecast for 2002 and 2003 by DRI boosts light vehicle sales. Unit light vehicle sales fall back slightly from the record levels of 1999 in 2001 and 2002, but by 2003 DRI forecasts the volume of light vehicle sales to be at record levels.

Light Vehicle Sales Hit Record 17.95 Million Units in 2003



Other Revenues

Other tax and non tax revenues, including tobacco settlement payments, are forecast to total \$3.268 billion in the 2002-03 biennium, up \$609 million or 22.9 percent from current estimates for 2000-01. Nearly 70 percent of that additional revenue comes from the tobacco settlement. Under current law both the continuing and the one-time settlement payments go to the general fund in 2002 and 2003. In 2000 and 2001 the one-time payments were dedicated to the Medical Education Endowment Fund and the Tobacco Prevention Endowment Fund.

Other non-tobacco tax and non-tax revenues were \$102 million (3.2 percent) above end-of-session estimates. Projections for investment income, the insurance gross premiums tax, the deed and mortgage taxes, and departmental earnings were all increased. The investment income estimate assumes that only the current level of reserves will remain through the biennium and that the current available general fund balance will be completely drawn down by the close of FY 2003.

Tobacco revenues fall by \$11 million from end-of-session projections because the volume of cigarette sales is forecast to continue to fall.

Revenue Planning Estimates FY 2004-05

The first planning estimates for the 2004-05 biennium project general fund current resources to total \$31.272 billion, an increase of \$3.061 billion or 10.9 percent over the current forecast for the 2002-03 biennium. Net non-dedicated revenues reach \$30.908 billion, also \$3.061 billion more than is forecast for 2002-03. The total of the four major revenues grows by 13.1 percent, despite a 9.8 percent drop in motor vehicle sales tax revenues due to completion of the phase in of the dedication of 32 percent of collections to the Highway User Fund. Individual income tax receipts grow by 14.8 percent from levels forecast for the 2002-03 biennium; the sales tax, by 12.4 percent.

FY 2004-05 Revenue Forecast (\$ in millions)

	<u>FY 2002-03</u>	<u>FY 2004</u>	<u>FY 2005</u>	<u>FY 2004-05</u>
Revenues				
Individual Income Tax	\$13,293	\$ 7,400	\$ 7,856	\$15,256
Sales Tax	8,600	4,702	4,964	9,665
Corporate Income Tax	1,735	994	1,031	2,025
Motor Vehicle Sales Tax	<u>953</u>	<u>423</u>	<u>436</u>	<u>859</u>
Four Major Taxes	24,580	13,519	14,287	27,806
Other Revenues	2,629	1,346	1,365	2,711
Tobacco Settlement	<u>639</u>	<u>194</u>	<u>198</u>	<u>393</u>
Net Non-dedicated Revenue	27,848	15,058	15,850	30,908
Other Resources	<u>363</u>	<u>182</u>	<u>182</u>	<u>364</u>
Current Resources	\$28,211	\$15,240	\$16,032	\$31,272

No one can forecast the path of the economy five years into the future. These baseline revenue planning estimates are not explicit forecasts, they are extrapolations of projected trends in the economy, and even small deviations from the assumed trend over five years will compound and produce sizeable changes in revenues. Because of the way these estimates are constructed any change in the base level of revenues for fiscal 2003 will be reflected in the revenue planning estimates for 2004 and 2005. Other things equal, stronger than anticipated revenue growth in fiscal 2001, fiscal 2002, or fiscal 2003 will carry forward and add significantly to revenues in the 2004-05 biennium. Similarly, should the economy grow more slowly than forecast during the next three years the revenue outlook for the 2004-05 biennium will deteriorate.

The revenue planning estimates are only a guide to the level of future revenues. They are not a guarantee. If the economy remains as strong as DRI projects through 2005 and if projections of capital gains realizations are accurate, these planning estimates are likely to slightly understate the actual revenues. But if the economy fails to perform at the high

level assumed in the November 2000 DRI Control, the planning estimates will significantly overstate future revenues. Actual revenues could exceed or fall short of the planning estimates by \$1.5 billion or more, depending on the economy's performance during the next 4 years.

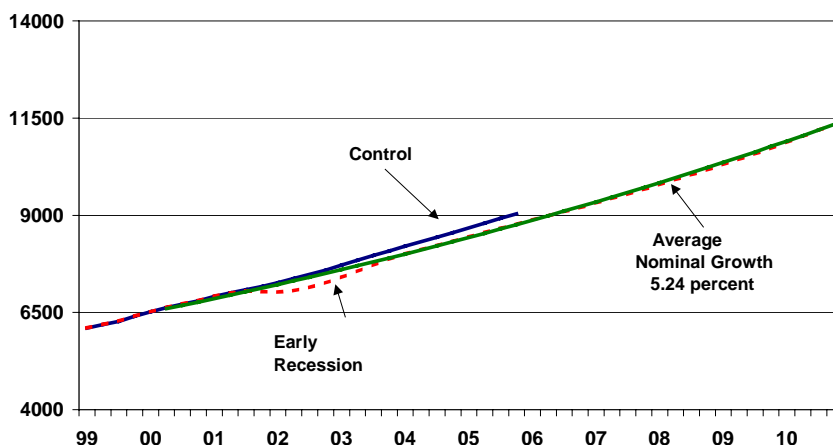
As is customary when the first planning estimates are prepared for a new biennium, Finance Department economists evaluated the methodology used. The current method was adopted in response to an observed positive bias in the revenue planning estimates created by the use of the Trendlong forecast as the base for the long-term estimates. Since November, 1994 the Finance Department has relied on a hybrid estimate of nominal growth which combines the Control inflation rate for the years covered by the planning estimate with the average annual real growth rate over the Cyclelong forecast for DRI's entire 25 year forecast horizon. It has also been Finance Department practice to replace the first year of the hybrid estimate with values from the Control forecast in November of odd numbered years. This practice limited use of the hybrid projection to forecasts for calendar years beginning more than three years into the future. For example, last February's 2002-03 planning estimates used the hybrid estimate for only the final six months of fiscal 2003. Values for calendar years 2001 and 2002 were taken from the February Control.

One alternative considered was use of the DRI Control forecast for all five years. This simplifies the forecast process and makes it easier to explain the method followed. But since it is highly unlikely that any forecasting service will call a recession four or five years into the future, it would introduce a positive bias to the forecast. Past history also indicates that it is likely to introduce more volatility into the forecast. When consulted Minnesota's Council of Economic Advisors cautioned against use of the Control forecast in the planning estimates, noting that basing the state's outlook for the next five years on a forecast which assumes that nothing ever goes wrong would not be wise.

Finance Department economists noted that the Blue Chip Long Range Consensus calls for 3.5 percent real GDP growth in 2004 followed by 3.4 percent in 2005. They also noted that the Congressional Budget Office, which currently assumes 2.7 percent real growth in its long term projections had been urged by their outside economic advisors to scale back their proposed long-term real growth rate of 3.3 percent for their out-year forecast. The Office of Management and Budget currently assumes 2.9 percent real growth in 2004 and 2005.

Finance Department agreed with the Council of Economic Advisors that the Control forecast's projections of 3.8 percent real economic growth in 2004 and 3.4 percent growth in 2005 were imprudent. Department economists believe that annual growth rates near 3.2 percent would provide a more realistic base for that forecast. A set of estimates of the growth rate for individual elements of the tax base consistent with a 3.2 percent real GDP growth rate were obtained by taking the average nominal growth rate from the current early early recession(Pessin) scenario over the entire ten years of that forecast.

**Revenue Planning Estimates Assume 5.24 Percent
Nominal GDP Growth for 2004 and 2005**



The individual income tax estimates were prepared using the House Income Tax Simulation Model. Assumed filer growth in Minnesota was consistent with average national employment growth over the entire ten year early recession scenario. All elements of income and all individual itemized deductions were assumed to grow at the growth rate of taxable personal income -- the combination of wages and salaries, proprietors' incomes, dividends, interest, and rents -- as forecast by DRI. Calendar year income tax liabilities were converted into fiscal year revenues using the same proportions as forecast for 2003.

Future sales tax revenues were estimated by computing percentage growth rates for each of 14 broad categories of items in Minnesota's sales tax base. Prior to this forecast only eight categories were used. Revisions to DRI's model made forecasts of a number of subcategories of the prior categories available, so the model was expanded to accommodate the availability of additional data. The growth rates used were based on the 10 year average growth rate from the early recession scenario. The sum of the weighted growth rates was used as a measure of the expected growth in the sales tax base for 2004 and 2005.

Corporate tax receipts in Minnesota were estimated to grow at the same rate as in DRI's Control forecast of national before tax corporate profits. Minnesota's motor vehicle excise tax collections are expected to grow at the 10 year average growth rate for national consumption of motor vehicles and parts from the early recession scenario. The deed and mortgage tax was forecast based on the projected growth in the value of new and existing home sales. Planning estimates for other tax and non tax revenues were prepared by extrapolating existing trends.

Expenditure Estimates

FY 2002-05

FY 2002-03 Biennial Budget Expenditure Estimates

Projected state general fund expenditures for FY 2002-03 total \$26.125 billion, a 6.2 percent increase over the current forecast for FY 2000-01 spending.

FY 2002-03 Expenditure Estimates

(\$ in millions)

	<u>FY 2000-01</u> <u>Biennium</u>	<u>FY 2002-03</u> <u>Biennium</u>	<u>\$ Change</u>	<u>Pct. Change</u>
Education / Children & Families	\$ 8,298	\$ 8,825	\$ 527	6.4%
Post-Secondary Education	2,642	2,749	107	4.1%
Property Tax Aids & Credits	3,288	3,543	255	7.7%
Other Major Local Assistance	1,165	1,208	42	3.6%
Health Care	3,698	4,747	1,049	28.4%
Family Support	434	445	11	2.5%
State Operated Institutions	956	1,023	67	7.0%
Legisl., Judicial, Const. Officers	619	640	21	3.3%
State Agencies' Operations & Grants	1,993	1,854	(139)	(7.0%)
Debt Service	567	632	65	11.5%
Capital Projects	89	15	(74)	NM
Transportation Projects, Tabs	569	181	(388)	NM
Estimated Cancellations	<u>(22)</u>	<u>(20)</u>	<u>2</u>	<u>NM</u>
Subtotal-Major Spending Categories	24,298	25,842	1,544	6.4%
Dedicated Expenditures	<u>301</u>	<u>283</u>	<u>(18)</u>	<u>6.1%</u>
Total Expenditures & Transfers	\$24,599	\$26,125	\$1,526	6.2%

Major growth areas in state spending for FY 2002-03 over the current biennium continue to be K-12 education, property tax aids and credits programs, and health care. State agency costs are actually projected to fall in FY 2002-03 due to a significant amount of one-time appropriations in FY 2000-01. General Fund appropriations for capital projects related to transportation and other areas are similarly highlighted. These reflect one-time appropriations in FY 2000-01 that are not reflected in FY 2002-03.

The expenditure projections include a 2.0 percent annual across-the-board inflation increase for budget planning purposes. The estimate is based on DRI's forecast of the Consumer Price Index (CPI). The 2.0 percent annual rate is a reduction from 2.5 percent annually forecast in February. While funding projected inflation is not required, the adjustment reflects the impact of expected price increases on the aggregate cost of government operations. General Fund appropriations for capital projects related to transportation and other areas are similarly highlighted. These reflect one-time appropriations in FY 2000-01 that are not reflected in FY 2002-03.

The inclusion of an inflation estimate does not imply actual cost increases or potential funding decisions for any specific program area. Instead, it is included to indicate the potential impact of uniformly adjusting state spending for projected increases in the Consumer Price Index. The following table displays projected inflation by program area to illustrate the potential impact of inflation if it were uniformly applied to all areas of the budget.

Estimated Inflation, FY 2002-03

(\$ in millions)

	FY 2002-03 Base	Estimated Inflation	Total FY 2002-03
Education / Children & Families	\$ 8,566	\$259	\$ 8,825
Post-Secondary Education	2,668	81	2,749
Property Tax Aids & Credits	3,438	105	3,543
Other Major Local Assistance	1,172	35	1,208
Health Care	4,605	141	4,747
Family Support	432	13	445
State Operated Institutions	993	30	1,023
Legisl., Judicial, Const. Officers	621	19	640
State Agencies' Operations & Grants	1,800	54	1,854
Debt Service	632	0	632
Capital Projects	15	0	15
Transportation Projects, Tabs	181	0	181
Estimated Cancellations	<u>(20)</u>	<u>0</u>	<u>(20)</u>
Subtotal-Major Spending Categories	25,106	737	25,842
Dedicated Expenditures	<u>283</u>	<u>0</u>	<u>283</u>
Total Expenditures & Transfers	\$25,388	\$737	\$26,125

The November, 2000 expenditure forecast for the FY 2002-03 biennium totals \$26.125 billion, a \$118 million decrease from the comparable estimates at the end of the 2000 legislative session. Most areas of state spending are now projected lower than the end-of-session estimates.

FY 2002-03 Expenditure Forecast Changes

(\$ in millions)

	<u>End of 2000 Session</u>	<u>November 2000</u>	<u>Difference</u>
Estimated Spending by Function			
Education / Children & Families	\$ 8,877	\$ 8,825	(52)
Post-Secondary Education	2,782	2,749	(33)
Property Tax Aids & Credits	3,642	3,543	(99)
Other Major Local Assistance	1,210	1,208	(2)
Health Care	4,723	4,747	23
Family Support	433	445	12
State Operated Institutions	1,049	1,023	(26)
Legisl., Judicial, Const. Officers	588	640	52
State Agencies' Operations & Grants	1,849	1,854	5
Debt Service	631	632	1
Capital Projects	15	15	0
Transportation Projects, Tabs	181	181	0
Estimated Cancellations	<u>(20)</u>	<u>(20)</u>	<u>0</u>
Subtotal-Major Spending Categories	\$25,960	\$25,842	(118)
Dedicated Expenditures	<u>283</u>	<u>283</u>	<u>0</u>
Total Expenditures & Transfers	\$26,243	\$26,125	(118)

Most of the changes reflect the change in the inflation assumption. One exception is forecast increases in health care that reflect the reduction in the federal share of the state's medical assistance program.

The estimated cost of inflation at 2.0 percent per year is \$737 million. This is a reduction of \$183 million from the \$920 million included in previous planning estimates – reflecting a reduction in DRI's forecast for the Consumer Price Index (CPI) from 2.5 percent to 2.0 for FY 2002-03.

FY 2004-05 Expenditure Planning Estimates

The 2004-05 planning estimates project expenditures beyond the upcoming budget biennium. These out-year estimates provide a baseline from which to measure the longer term affordability of policy choices that might be considered in the 2001 legislative session.

FY 2004-05 Planning Estimates
(\$ in millions)

	<u>FY 2002-03</u>	<u>FY 2004-05</u>		<u>Pct.</u>
	<u>Biennium</u>	<u>Biennium</u>	<u>\$ Change</u>	<u>Change</u>
Estimated Spending by Function				
Education / Children & Families	\$ 8,825	\$ 9,312	\$ 486	5.5%
Post-Secondary Education	2,749	2,924	175	6.4%
Property Tax Aids & Credits	3,543	3,827	284	8.0%
Other Major Local Assistance	1,208	1,291	84	6.9%
Health Care	4,747	5,865	1,118	23.6%
Family Support	445	461	16	3.6%
State Operated Institutions	1,023	1,093	70	6.8%
Legisl., Judicial, Const. Officers	640	673	33	5.2%
State Agencies' Operations & Grants	1,854	1,936	82	4.4%
Debt Service	632	656	24	3.8%
Capital Projects	15	35	20	nm
Transportation Projects, Tabs	181	0	(181)	nm
Estimated Cancellations	<u>(20)</u>	<u>(20)</u>	<u>0</u>	<u>nm</u>
Subtotal-Major Spending Categories	25,842	28,052	2,172	8.6%
Dedicated Expenditures	<u>283</u>	<u>283</u>	<u>0</u>	<u>0.0</u>
Total Expenditures & Transfers	\$26,125	\$28,296	\$2,211	8.5%

All FY 2004-05 expenditure projections begin with the forecast level of spending for FY 2001. Like the estimates for FY 2002-03, these projections are based on current law, incorporating forecast caseload and enrollment changes and an additional 2.5 percent each year for estimated inflation.

Education Base Spending Grows by \$269 Million in FY 2002-03; Fewer Pupils Offset by More General Education Spending

Education spending is projected to total \$8.825 billion in FY 2002-03, an increase of \$527 million over the current biennium. This increase includes \$269 million of current law program growth and \$259 million in estimated inflation.

Of the \$269 million base increase, \$197 million is in General Education, largely reflecting the biennial cost of fully implementing several decisions made in FY 2000-01, partially offset by decreased student enrollment. Three factors account for \$223 million of the change. These include an increase in the general education formula allowance (the primary source of general operating funds for school districts) of \$210 in FY 2000 and \$224 in FY 2001; implementation of enhanced class size reduction funding; and the introduction and evolution of marginal cost pupil unit formulas. As the chart indicates, the formula increases result in an allowance of \$3,964 per pupil unit in FY 2001 and later years.

Enrollment Change and General Education Formula Amounts						
	FY 2000-01		FY 2002-03		FY 2004-05	
	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Projected K-12 Enrollment (Average Daily Membership)	853,364	853,381	852,641	851,590	849,811	847,855
Annual Percent Change		0.0%	-0.09%	-0.12%	-0.21%	-0.23%
General Education Formula Allowance Amount	\$3,740	\$3,964	\$3,964	\$3,964	\$3,964	\$3,964

Other factors in the \$197 million General Education increase:

- the continued phase-out of training & experience revenue, decreasing costs by \$46 million
- increases in the state-equalized portion of referendum revenues, costing \$22 million
- continued growth in the number of students with Limited English Proficiency, increasing costs by \$11 million
- \$16 million more in costs associated with growth in the number of compensatory students, primarily at charter schools
- other miscellaneous changes that net to a decrease of \$29 million.

The remaining portion of the \$269 million increase in the base reflects changes in categorical aid programs (aid provided to school districts for more specific purposes than general education funds). The largest of these include:

- \$153 million more in special education programs, including \$111 million in regular special education and \$40 million in special education excess cost aid. The increase in regular special education reflects the statutory growth factors, while the excess cost increases can be attributed to statutory growth factors and slightly higher transportation and instructional costs beginning in FY 2001

- \$27 million more in integration aid, reflecting the continued implementation of the desegregation rule adopted last February
- \$28 million more in aid to charter schools, with \$26 million in building lease aid and \$2 million more in start-up aid. These increases reflect a projected rise in both the number of charter schools and charter school enrollment
- \$17 million more in adult basic education, due to implementation of the enhanced formula enacted last year
- \$138 million less due to the removal of one-time or expiring programs, including \$24 million in discontinued secondary vocational aid
- \$12 million less in debt service, reflecting increases in property values that result in decreased state aid obligations
- Other offsetting changes that net to a decrease of \$3 million.

FY 2004-05 Education Costs Driven by Inflation, with Little Base Growth

In FY 2004-05, spending in education programs is projected to increase by \$745 million, to \$9.312 billion. Estimated inflation adds \$688 million, while other forecast changes increase costs by only \$57 million over FY 2002-03 base levels.

Under current law, General Education is projected to decrease by \$88 million from FY 2002-2003. Lower enrollment combined with a \$50 million decline in the state share of referendum revenue, and a \$27 million decrease in training and experience revenue account for the largest share of this decrease. Increases in students eligible for Limited English Proficiency revenue (\$11 million) and compensatory aid (\$15 million) partially offset this decrease.

Categorical aid programs increase, however, with the largest growth attributable to charter schools and special education. Increases in the number of charter schools and the number of charter school students is projected to continue, with a \$51 million increase over FY 2002-03 in charter school building lease aid and a \$4 million increase in charter school start-up aid. In special education, annual statutory growth factors of 4.6 percent for regular special education and 2 percent for excess cost aid add an estimated \$103 million to the forecast. Other major categorical changes include a \$9 million decrease in debt service equalization and an \$11 million increase in adult basic education. The expiration of telecommunication access revenue reduces projected spending in by an additional \$20 million.

Higher Education Spending Shows Little Change, Driven Primarily by Inflation Estimates

Projected FY 2002-03 spending for post-secondary education is expected to increase \$107 million over the current biennium. However, of this amount, total current law spending for higher education spending is expected to rise only \$26 million in the next biennium, a change of 1% from FY 2000-01. Most of this growth is due to an increase in the appropriation to MnSCU and the University of Minnesota in the second year of the previous biennium carrying forward into both years of the FY 2002-03 biennium.

Estimated inflation adds nearly \$81 million for the FY 2002-03 and an additional \$135 million for FY 2004-05.

Enrollment adjustments, primarily at MnSCU, will limit current law spending growth in FY 2002-03. MnSCU will make a one-time payback of \$27 million for an enrollment decline from FY 1995 to FY 1999. This will be partially offset by adjustments for a rebound in enrollment in FY 2000, and projected increases in succeeding years. The University will also make a one-time payback of \$6 million for projected enrollment increases in the previous biennium that did not materialize. In total, enrollment adjustments represent a \$12 million decrease in appropriations in the 2002-03 biennium. One-time appropriations of \$12 million also do not continue into the next biennium.

These factors contribute to a reduction in state dedicated reserves. MnSCU's reserve balance is expected to decrease by \$25 million during the FY 2002-03 biennium to \$111 million. Projected increase in tuition revenue are not expected to offset enrollment adjustments and expected increases in expenditures in FY 2003.

Aids & Credits Forecast Rises \$255 Million for 2002-2003 Biennium

Property tax aid and credit expenditures for FY 2002-03 are expected to be \$3.543 billion, an increase of \$255 million (7.7 percent) over FY 2000-2001. Of this increase, \$105 million is attributable to discretionary inflation.

Highlights of the remaining \$150 million in Local Aid and Credit changes include the following:

- \$186 million expenditure increase due to expansion of the Education Credit Aid programs (both Homestead and Agricultural--\$117 and \$69 million respectively).
- \$139 million expenditure reduction for programs ending in the current biennium, including Local Performance Aid (\$10 million), Charity Care Aid (\$10 million), Agricultural Disaster Relief (\$18 million), Farm Aid (\$41 million), and Minnesota Minerals 21st Century Fund (\$60 million).
- \$52 million expenditure increase in Local Government Aid with about \$31 million of that tied to statutory inflation.
- \$26 million expenditure increase anticipated Property Tax Refunds (primarily higher renter refunds due to escalating rents).
- \$22 million expenditure increase in Family Preservation Aid as the increase for FY 2001 continues in both years of the 2002-03 biennium.
- \$22 million expenditure reduction in the Homestead and Agricultural Credit Aid (HACA) program continuing a shift of school HACA to general fund support for special education costs.
- \$14 million expenditure increase for Police and Fire aids tied to continued growth in insurance premium taxes.

Aids & Credits Forecast Rises \$284 Million for 2004-2005 Biennium

Expenditures for local aids and credits for the 2004-05 biennium are expected to be \$3.827 billion, an increase of \$284 million (8 percent) over FY 2002-03 forecast levels. Of this increase, \$180 million is attributable to discretionary inflation. Other changes include the following:

- \$45 million expenditure increase in Local Government Aid with about \$33 million tied to statutory inflation.
- \$26 million expenditure increase anticipated in Property Tax Refunds as home values and rent costs continue to rise.
- \$16 million expenditure increase (2 percent) in the Education Credit Aid programs (Homestead and Agricultural).
- \$12 million expenditure increase in Police and Fire aids tied to continued growth in insurance premium taxes.

Health Care Spending Expected to Grow by \$1.049 Billion in 2002-03

The state share of health care spending for the next biennium is forecast to grow 28 percent over current biennium spending. This increase of \$1.049 billion is due to a number of factors, including lower federal financial participation, growth in health care costs, growth in program enrollment, and estimated inflation.

Growth in health spending has been accelerated by reductions in the federal share of program costs. Minnesota's federal matching (FMAP) rate will fall from its current level of 51.11 percent to the federal minimum of 50 percent, beginning in October, 2001. This relatively small decline in federal participation on a program the size of MA results in an additional \$79 million General Fund cost in FY 2002-03. A separate discussion of this change is highlighted in the FY 2002-05 Outlook section.

Estimated inflation contributes \$141 million to the growth over the current biennium.

These costs are partially offset by lower-than-forecast spending in two of the long-term care waiver programs. The Elderly Waiver is now forecast to expand more slowly than previously anticipated, and the Waiver for People with Developmental Disabilities is forecast to have lower average costs of approximately 5 percent in 2002 and 8 percent in 2003.

Most of the growth in health care spending in FY 2002-03 is found in three categories of MA spending—LTC Waivers, Elderly and Disabled Basic Care, and MFIP and Families Basic Care. Long-Term Care Facilities, while still the largest portion of MA spending in the 2002-03 biennium, exhibits much lower biennium-to-biennium change by comparison. The following table breaks out the biennium-to-biennium changes for each segment of health care spending:

Health Care Changes, 2002-03 vs. 2000-01

(Base forecast for programs, \$ in millions)

	<u>2000-01</u>	<u>2002-03</u>	<u>\$ Change</u>	<u>Pct. Change</u>
MA-Long Term Care Facilities	\$1,069	\$1,145	\$ 76	7.1
MA-Long Term Care Waivers	726	986	260	35.8
MA-Elderly & Disabled Basic Care	832	1,138	306	36.8
MA-MFIP & Families Basic Care	706	895	189	26.8
General Assistance Medical Care	264	329	65	24.6
Senior Drug Program	17	25	8	47.1
Chemical Dependency Entitlements	84	87	3	3.6
Estimated Inflation	<u>0</u>	<u>141</u>	<u>141</u>	<u>0.0</u>
	\$3,698	\$4,746	\$1,048	28.3%

Rising health care spending is driven by familiar factors: increasing enrollment and rising cost of care. As noted in a separate discussion of the state's own health plan, costs for some health services have been growing by more than 20 percent in recent years. Depending on the type of service, health costs may also be under pressure due to changes in technology, labor shortages, or increased utilization rates. A summary of the rising enrollment projected for Medical Assistance is summarized for below.

MA Enrollment Growth, FY 2000-05

	<u>Monthly Average Enrollment FY 2000</u>	<u>Monthly Average Enrollment FY 2005</u>	<u>Change FY 2000-05</u>	<u>Pct. Change FY 2000-05</u>
<u>Medical Assistance Segment</u>				
Elderly/Disabled Basic Care	119,242	141,630	22,388	18.8%
MFIP/Families Basic Care	244,111	261,442	17,331	7.1%

MA Long Term Care Utilization, FY 2000-05

	<u>Monthly Average Recipients FY 2000</u>	<u>Monthly Average Recipients FY 2005</u>	<u>Change FY 2000-05</u>	<u>Pct. Change FY 2000-05</u>
<u>Medical Assistance Segment</u>				
LTC Facilities	29,616	30,774	1,158	3.9%
LTC Waivers	26,946	38,949	12,003	44.5%

FY 2004-05 Health Care Spending Estimated to Increase \$1.118 Billion

Rising costs in the Medical Assistance program continue to push health care spending higher in the 2004-05 biennium, with estimated spending at \$5.865 billion. The \$1.118 billion increase is 24 percent above the prior biennium's estimates. Estimated inflation is \$294 million of this increase over the 2002-03 biennium (\$435 million increase over 2004-05 base). Projected growth by program is shown in the following table:

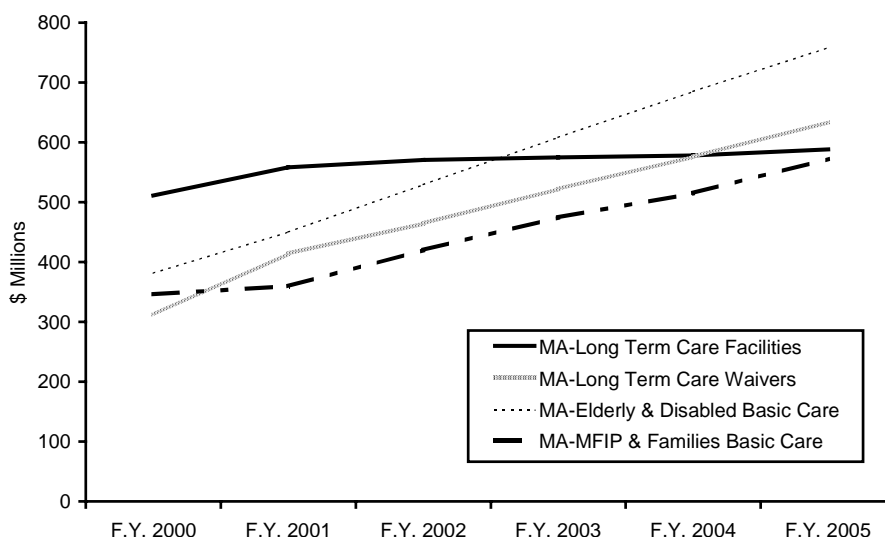
Health Care Changes, 2004-05 vs. 2002-03

(Base forecast for programs, \$ in millions)

	<u>2002-03</u>	<u>2004-05</u>	<u>\$ Change</u>	<u>Pct. Change</u>
MA-Long Term Care Facilities	\$1,145	\$1,167	\$ 22	1.9
MA-Long Term Care Waivers	986	1,210	224	22.7
MA-Elderly & Disabled Basic Care	1,138	1,444	306	26.9
MA-MFIP & Families Basic Care	895	1,088	193	21.6
General Assistance Medical Care	329	392	63	19.1
Senior Drug Program	25	28	3	12.0
Chemical Dependency Entitlements	87	100	13	14.9
Estimated Inflation	141	435	294	0.0
	\$4,746	\$5,865	\$1,118	23.5%

Estimates for MA in the 2004-05 biennium show the result of Minnesota's efforts to move people with continuing care needs out of institutional settings and into community-based settings. For the first time in 2004-05, MA Long-Term Care Facilities will no longer be the largest component of MA spending. MA LTC Waivers and Elderly and Disabled Base Care are both estimated to have higher spending levels than LTC facilities.

Base Forecast for Medical Assistance (MA)



2002-03 Family Support Spending Forecast to Increase \$12 Million

Spending on family support programs is estimated to be \$445 million in FY 2002-03, an increase of \$11 million over the current biennium. While base spending actually decreases by \$2 million, estimated inflation adds an additional \$14 million.

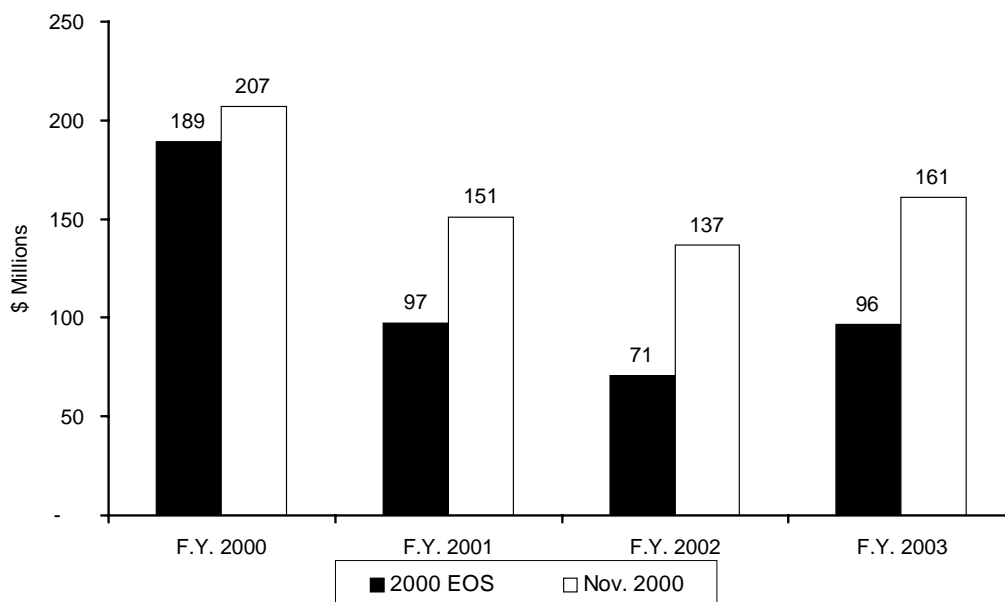
These minor changes mask significant movement within most family support programs. MFIP spending is forecast to be \$85 million lower than the current biennium, while Child

Care Assistance is estimated to rise by \$110 million. These changes are mostly due to the one-time use of TANF funds for child care in FY 2000-01. As child care in FY 2002-03 reverts back to a greater share of state funding, less state money is needed in MFIP.

Additionally, the General Assistance (GA) program is forecast to be \$22 million lower in FY 2002-03 due to the shift of Battered Women Shelter payments out of GA. Last year (FY 2000) was the final year in which GA covered payments to these shelters. This decline is offset by slightly higher per person costs than previously expected.

MFIP and Child Care estimates for FY 2003 assume no change in federal TANF requirements or funding levels. The federal TANF law expires three months into state FY 2003, and reauthorization changes made by Congress before that time may impact General Fund and TANF spending for FY 2003 and beyond.

TANF Reserve Levels



The TANF Reserve levels change only modestly in FY 2002-03, although the impact of the 60-month time limit on the receipt of MFIP benefits is evident in the reserve balances for FY 2003. Current state law does not allow receipt of MFIP beyond 60 months for most cases, so the forecast shows a decline of 4,800 cases (or approximately 12 percent of the average monthly caseload) in FY 2003.

Family Support Spending Expected to Grow by \$16 Million in 2004-05

The stable nature of the state's TANF MOE requirement keeps Family Support spending from rising significantly in the future. MOE is a constant figure, ensuring that increases in child care spending are offset by decreases in MFIP spending. Family Support spending is forecast to be \$16 million higher in 2004-05 than the 2002-03 biennium.

There is a slight decline in the MFIP base forecast from the 2002-03 base that is more than offset by the impact of estimated inflation which contributes \$39 million to the forecast Family Support spending of \$461 million in 2004-05.

By FY 2004-05, child care assistance will have replaced cash assistance as the primary form of family support by the state. This reflects a shift in policies initiated by federal welfare reform. In FY 1996-97, child care assistance was only 7% of family support spending. In the FY 2004-05 biennium, child care will be almost two-thirds of state spending in this area.

State Institution Costs Projected to Rise \$67 Million in FY 2002-03, \$70 Million in FY 2004-2005

The cost of operating state institutions (residential treatment centers, prisons, Faribault Academies, the Arts School and veteran's homes) is expected to increase \$67 million under FY 2002-03 planning estimates. Estimated inflation accounts for \$30 million of the growth.

Spending for FY 2002-03 grows by \$46 million due to an increasing inmate population at state prisons. This change includes \$15 million for inflation and \$31 million for increasing numbers of inmates. The cost for new inmates is lower than in the last forecast because of a change in methodology. This forecast uses the marginal cost for new prisoners based on current staffing and operating cost factors. In the past, the forecast used average costs.

Costs for state Regional Treatment Centers (RTC's) operated by the Department of Human Services are forecast to grow by \$14 million, but most of this change is inflation.

The Minnesota Veterans Homes, operated by the Veterans Homes Board, will also see modest growth in the FY 02-03 biennium. Of the \$6 million in growth, \$4 million reflects the costs associated with returning nursing home beds to service that have been vacant during the renovation and restoration of the Minneapolis campus. The balance of the growth is inflation.

FY 2004-05 planning estimates for state institutions show net growth of \$70 million over FY 2002-03 forecast levels. The most significant factors in this growth are inflation of \$34 million and caseload increases in state correctional institutions estimated to cost \$22 million. Projections by the Department of Corrections estimate the number of adult inmates at about 7,300 by the end of FY 2005, nearly 1,100 more than the current count. The growth in Corrections is offset by a \$4 million (before inflation) reduction in RTCs spending. These savings are associated with the movement in the previous biennium of individuals with development disabilities out of the RTCs and into community-based residential settings.

Fiscal Year 2002-03 Debt Service Costs

The net debt service estimate for the 2002-03 biennium is \$632 million, which is \$2 million more than forecast at the end of session. The increase is the result of selling more bonds in the 2002-03 biennium, partially offset by a forecast of lower interest rates. The \$632 million is the amount needed during the 2002-03 biennium to meet the constitutional requirements for the debt service transfer from the general fund to the debt service fund on outstanding general obligation bonds, additional bond sales for currently authorized projects, and to fund future capital budgets of \$400 million in even numbered years and \$50 million in odd numbered years.

Fiscal Year 2004-05 Debt Service Planning Estimates

Forecast debt service for the 2004-05 biennium is \$656 million. This is an increase of \$24 million over the 2002-03 biennium estimate. The forecast assumes \$400 million capital budgets are enacted in odd-numbered years, and \$50 million in even-year sessions.

All Other Spending Will Decline from the Current Biennium

The majority of state agencies and programs, outside the major forecast areas, will show a net decline from the FY 2000-01 biennium to projected spending for FY 2002-03. The reason for this is twofold. First the FY 2001 appropriation is the basis for FY 2002-03 spending by year. Second, one-time appropriations do not continue into the base spending levels for the next biennium. A large number of one-time appropriations occurred in the current biennium. Examples of these include \$50 million for low-income housing and a general fund transfer to the Workforce Development Fund of \$29 million. The amount of the reductions associated with one-time funding in the current biennium more than offsets the estimated 2.0 percent inflation added to the planning estimates for FY 2002-03. A net reduction is the result when comparing the projected growth from FY2000-01 to FY 2002-03 estimated spending.

Capital Projects Spending Shows Similar Declines

In some cases direct general fund appropriations (cash) are made for capital projects in addition to authorized bonding. For FY 2000-01 this amounted to \$152 million. This amount does not continue into the FY 2002-03 biennium. This category of spending also contains estimates for the future operating costs associated with major capital projects. End of session estimates assumed operating expenses of \$5 million in FY 2002 and \$10 million in FY 2003. The estimates remained unchanged. For FY 2004-05 these costs would continue, and similar increases in operating expense have been added for assumed future capital budgets.

One-time Funding in FY 2001 for Transportation-related Capital Projects and Motor Vehicle License Reduction Distort Spending Growth Comparisons

The detail of general fund expenditures highlights the unique funding in FY 2000-01 provided for transportation related projects. One-time general fund appropriations totaling \$63 million were made for transportation construction capital projects (included with capital projects totals previously mentioned), \$332 million was provided for highway construction projects, and \$25 million allocated to transitway construction. An additional transitway appropriation of \$19 million was made for FY 2002. With the exception of the FY 2002 monies, this funding does not recur in the estimates for the FY 2002-03 biennium.

Also included in this spending category is \$150 million in FY 2001 appropriated for transfer to the Highway User fund for the purpose of reimbursing the fund for reduced revenues resulting from the motor vehicle license fee reduction that went into effect in July 2000. FY 2002 spending estimates include a similar amount, \$162 million for this purpose. For FY 2003, however, no amount is shown as spending for this purpose. Effective in FY 2003, an amount equal to 32 percent of the forecast motor vehicle sales tax (\$193 million) will be deposited directly to the Highway User fund. For FY 2003 and following years, this provision serves to reduce general fund revenues -- rather than appear as a spending item.

Selected Statutory Provisions

16A.1522 Rebate requirements.

Subdivision 1. **Forecast.** If, on the basis of a forecast of general fund revenues and expenditures in November of an even-numbered year or February of an odd-numbered year, the commissioner projects a positive unrestricted budgetary general fund balance at the close of the biennium that exceeds one-half of one percent of total general fund biennial revenues, the commissioner shall designate the entire balance as available for rebate to the taxpayers of this state. In forecasting, projecting, or designating the unrestricted budgetary general fund balance or general fund biennial revenue under this section, the commissioner shall not include any balance or revenue attributable to settlement payments received after July 1, 1998, and before July 1, 2001, as defined in Section IIB of the settlement document, filed May 18, 1998, in *State v. Philip Morris, Inc.*, No. C1-94-8565 (Minnesota District Court, Second Judicial District).

Subd. 2. **Plan.** If the commissioner designates an amount for rebate in either forecast, the governor shall present a plan to the legislature for rebating that amount. The plan must provide for payments to begin no later than August 15 of the odd-numbered year. By April 15 of each odd-numbered year, the legislature shall enact, modify, or reject the plan presented by the governor.

Subd. 3. **Certification.** By July 15 of each odd-numbered year, based on a preliminary analysis of the general fund balance at the end of the fiscal year June 30, the commissioner of finance shall certify to the commissioner of revenue the amount available for rebate.

Subd. 4. **Transfer to tax relief account.** Any positive unrestricted budgetary general fund balance on June 30 of an odd-numbered year is appropriated to the commissioner for transfer to the tax relief account.

Subd. 5. **Appropriation.** A sum sufficient to pay any rebate due under the plan enacted under subdivision 2 is appropriated from the general fund to the commissioner of revenue.

Enacted Laws 1999 c 243 art 15 § 1

Alternative Forecast Comparison**Real GDP (Annual Rates)**

	<u>00II</u>	<u>00III</u>	<u>00IV</u>	<u>01I</u>	<u>01II</u>	<u>00A</u>	<u>01A</u>	<u>02A</u>	<u>03A</u>
DRI Control (11-00)	5.6	2.7	4.2	3.4	3.2	5.3	3.6	4.3	4.8
Blue Chip (11-00)	5.6	2.7	3.3	3.2	3.1	5.2	3.4	3.3	3.2
American Express (IDS) (11-00)	5.6	2.7	4.5	5.0	4.6	4.4*	4.0*	N.A	N.A
Merrill-Lynch (11-00)	5.6	2.7	3.3	3.5	3.8	5.2	3.7	N.A	N.A

* 4Q/4Q

Consumer Price Index (Annual Rates)

	<u>00II</u>	<u>00III</u>	<u>00IV</u>	<u>01I</u>	<u>01II</u>	<u>00A</u>	<u>01A</u>	<u>02A</u>	<u>03A</u>
DRI Control (11-00)	3.7	3.1	2.7	1.8	1.9	3.4	2.2	1.7	1.9
Blue Chip (11-00)	3.6	3.1	3.0	2.6	2.5	3.3	2.8	2.6	2.7
American Express (IDS) (11-00)	3.6	3.1	2.7	2.8	3.1	3.4*	3.1*	N.A	N.A
Merrill-Lynch (11-00)	3.6	3.1	2.6	1.8	1.9	3.4	2.3	N.A	N.A

* 4Q/4Q

Forecast Comparisons

Real Economic Growth

(Annual Percent Change in Real GDP)

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Nov 96 DRI Control	1.6 ⁽¹⁾	1.6 ⁽¹⁾				
Feb 97 DRI Control	1.6 ⁽¹⁾	1.6 ⁽¹⁾				
Nov 97 DRI Control	2.5	1.7 ⁽²⁾				
Feb 98 DRI Control	2.4	1.7 ⁽²⁾				
Nov 98 DRI Control	2.3	2.1	1.7 ⁽³⁾	1.7 ⁽³⁾		
Feb 99 DRI Control	1.9	2.3	1.7 ⁽³⁾	1.7 ⁽³⁾		
Nov 99 DRI Control	3.4	3.5	2.0 ⁽⁴⁾	2.0 ⁽⁴⁾		
Feb 00 DRI Control	3.6	2.9	3.4	2.0 ⁽⁴⁾		
Nov 00 DRI Control	5.3	3.6	4.3	4.8	3.2 ⁽⁵⁾	3.2 ⁽⁵⁾

Inflation

(Annual Percent Change in CPI-U)

Feb 97 DRI Control	3.2	3.4				
Nov 97 DRI Control	2.6	2.7	2.8			
Feb 98 DRI Control	2.9	2.8	2.8			
Nov 98 DRI Control	2.7	2.8	2.8	2.9		
Feb 99 DRI Control	2.3	2.3	2.4	2.5		
Nov 99 DRI Control	2.3	2.1	2.6	2.8		
Feb 00 DRI Control	2.4	2.2	2.5	2.6		
Nov 00 DRI Control	3.4	2.2	1.7	1.9	2.4	2.7

(1) Long-term trend from DRI Cyclelong, Summer 1996

(2) Long-term trend from DRI Cyclelong, Summer 1997

(3) Long-term trend from DRI Cyclelong, Summer 1998

(4) Long-term trend from DRI Cyclelong, Summer 1999

(5) 10 year trend from DRI Early Recession (Pessim), November, 2000

Minnesota - U.S. Comparison Report Annual Percent Changes**November 2000 Control**

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Wage and Salary Income							
United States	7.2	7.8	6.7	6.6	6.0	6.0	6.8
Minnesota	7.2	8.6	7.1	7.7	6.6	6.3	6.8
Implied Annual Wage							
United States	4.5	5.0	4.2	4.4	4.8	4.7	4.7
Minnesota	4.9	5.7	4.9	5.7	5.3	5.0	5.2
Non-Farm Employment							
United States	2.6	2.6	2.3	2.1	1.1	1.2	2.0
Minnesota	2.2	2.7	2.1	1.8	1.2	1.3	1.5
Personal Income							
United States	6.0	6.5	5.4	6.3	5.7	5.6	6.3
Minnesota	5.7	7.1	6.0	7.3	5.8	5.8	6.2

Comparison of Actual and Estimated Non-Restricted Revenues
Fiscal Year-To-Date Through October 2000
(\$ in Thousands)

	<u>Forecast</u> <u>Revenues</u>	<u>Actual</u> <u>Revenues</u>	<u>Variance</u> <u>Act-Fcst</u>
Individual Income Tax			
Withholding	1,495,300	1,511,764	16,464
Declarations	235,280	254,013	18,733
Miscellaneous	59,084	57,623	(1,461)
Gross	1,789,664	1,823,400	33,736
Refund	36,832	41,022	4,190
Net	1,752,832	1,782,377	29,546
Corporate & Bank Excise			
Declarations	213,300	237,656	24,356
Miscellaneous	33,300	53,398	20,089
Gross	246,600	291,054	44,454
Refund	23,000	38,022	15,022
Net	223,600	253,032	29,432
Sales Tax			
Gross	1,243,436	1,252,655	9,219
Refunds	43,641	59,260	15,619
Net	1,199,795	1,193,396	(6,400)
1999 Sales Tax Rebates	0	(493)	(493)
2000 Sales Tax Rebates	0	(663)	(663)
Motor Vehicle Sales	184,900	188,510	3,610
Other Revenues			
Inherit/Gift/Estate	29,415	20,621	(8,794)
Liquor/Wine/Beer	16,488	16,629	141
Cigarette/Tobacco/Cont Sub	52,765	53,801	1,036
Deed and Mortgage	47,686	53,523	5,837
Insurance Gross Earnings	3,185	2,422	(763)
Lawful Gambling	16,925	17,221	296
Health Care Surcharge	38,228	38,318	90
Other Taxes	425	325	(100)
DHS RTC Collections	7,600	2,842	(4,758)
Income Tax Reciprocity	0	0	0
Investment Income	25,115	47,089	21,974
Other Tax Refunds	0	0	0
Tobacco Settlement	0	0	0
Revenues yet to be allocated	0	1,482	1,482
Residual revenues less refunds	136,196	138,726	2,530
Other Subtotal	374,028	392,996	18,969
Other Refunds	5,262	3,770	(1,492)
Other Net	368,766	389,226	20,461
Total Gross	3,838,628	3,947,459	108,831
Total Refunds	108,735	142,074	33,339
Total Net	3,729,893	3,805,385	75,492

**Comparison of Actual and Estimated Non-Restricted
Revenues June, 2000 Close
(\$ in thousands)**

	Forecast Revenues	Actual Revenues	Variance Act-Fcst
Individual Income Tax			
Withholding	4,573,100	4,602,771	29,671
Declarations	1,144,800	1,160,220	15,420
Miscellaneous	589,461	686,401	96,940
Gross	6,307,361	6,449,392	142,031
Refund	854,300	893,021	38,721
Net	5,453,061	5,556,370	103,309
Corporate & Bank Excise			
Declarations	772,400	791,504	19,104
Miscellaneous	97,810	125,045	27,235
Gross	870,210	916,549	46,339
Refund	128,100	116,420	(11,680)
Net	742,110	800,129	58,019
Sales Tax			
Gross	3,906,900	3,933,734	26,834
Refunds	192,519	179,623	(12,896)
Net	3,714,381	3,754,111	39,730
1999 Sales Tax Rebates	(18,261)	(10,130)	8,131
2000 Sales Tax Rebates	(635,600)	(623,672)	11,928
Motor Vehicle Sales	529,500	540,961	11,461
Other Revenues			
Inherit/Gift/Estate	85,000	83,888	(1,112)
Liquor/Wine/Beer	60,021	62,138	2,117
Cigarette/Tobacco/Cont Sub	176,481	179,186	2,705
Deed and Mortgage	137,100	141,397	4,297
Insurance Gross Earnings	172,400	177,453	5,053
Lawful Gambling	63,795	65,432	1,637
Health Care Surcharge	124,906	125,887	981
Other Taxes	3,187	3,268	81
DHS RTC Collections	22,780	8,274	(14,506)
Income Tax Reciprocity	46,475	46,475	0
Investment Income	134,347	152,442	18,095
Other Tax Refunds	0	0	0
Tobacco Settlement	104,926	104,926	0
Revenues yet to be allocated	0	1,945	1,945
Residual revenues less refunds	103,911	111,107	7,196
Other Subtotal	1,235,329	1,263,821	28,492
Other Refunds	23,579	23,388	(191)
Other Net	1,211,750	1,240,433	28,683
Total Gross	12,195,439	12,470,656	275,217
Total Refunds	1,198,498	1,212,453	13,955
Total Net	10,996,941	11,258,203	261,262

Factors Affecting the Individual Income Tax

(\$ in billions)

	<u>1998</u>	<u>1999</u>	<u>Calendar Year</u>		<u>2002</u>	<u>2003</u>
			<u>2000</u>	<u>2001</u>		
Minnesota Non-Farm Tax Base						
November 1996 Control	105.170	109.960				
February 1997 Control	106.270	111.140				
November 1997 Control	111.700	116.240				
February 1998 Control	113.040	116.960				
November 1998 Control	113.850	118.500	123.620	128.830		
February 1999 Control	114.640	120.320	125.150	130.330		
November 1999 Control	112.920	119.790	126.630	133.200		
February 2000 Control	112.920	120.416	127.870	134.090		
November 2000 Control	120.590	128.770	138.670	146.530	155.040	165.080
Minnesota Wage and Salary Income						
November 1996 Control	78.407	82.127				
February 1997 Control	79.203	82.961				
November 1997 Control	80.099	83.793				
February 1998 Control	81.433	84.502				
November 1998 Control	82.538	86.724	91.370	95.761		
February 1999 Control	83.279	87.884	91.969	96.329		
November 1999 Control	83.980	89.550	95.060	100.590		
February 2000 Control	83.980	90.080	95.600	100.500		
November 2000 Control	83.750	89.680	96.555	102.910	109.420	116.870
Minnesota Property Income						
November 1996 Control	18.925	19.740				
February 1997 Control	19.011	19.782				
November 1997 Control	23.196	23.623				
February 1998 Control	23.112	23.606				
November 1998 Control	23.117	23.348	23.438	23.891		
February 1999 Control	23.129	23.787	24.317	24.821		
November 1999 Control	20.913	21.464	22.523	23.243		
February 2000 Control	20.813	21.509	22.984	23.956		
November 2000 Control	28.761	30.377	32.711	33.690	35.015	36.754
Minnesota Proprietors' Income						
November 1996 Control	7.834	8.099				
February 1997 Control	8.056	8.401				
November 1997 Control	8.400	8.821				
February 1998 Control	8.500	8.855				
November 1998 Control	8.193	8.429	8.808	9.182		
February 1999 Control	8.230	8.651	8.867	9.181		
November 1999 Control	8.134	8.774	9.045	9.365		
February 2000 Control	8.134	8.820	9.288	9.636		
November 2000 Control	8.079	8.710	9.405	9.938	10.607	11.455

Factors Affecting Sales, Corporate Income And Sales Tax on Motor Vehicles

(\$ in billions)

		<u>Fiscal Year</u>				
	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
SALES TAX						
Minnesota's Proxy Share of U.S. Consumer Durable Spending (Excluding Autos)						
November 1996 Control*	8.601	8.948				
February 1997 Control	8.705	9.026				
November 1997 Control	8.911	9.430				
February 1998 Control	8.802	9.226				
November 1998 Control	9.182	9.750	10.207	10.662		
February 1999 Control	9.187	9.854	10.456	10.828		
November 1999 Control	8.962	9.729	10.442	11.041		
February 2000 Control*	8.307	8.968	9.648	10.100		
November 2000 Control	8.196	8.895	9.875	10.512	11.124	11.978
Minnesota's Proxy Share of U.S. Capital Equipment Spending						
November 1996 Control	9.316	9.900				
February 1997 Control	9.503	10.154				
November 1997 Control	9.461	10.148				
February 1998 Control	9.344	10.038				
November 1998 Control	9.475	10.338	10.743	11.224		
February 1999 Control	9.485	10.417	11.103	11.461		
November 1999 Control	9.452	10.384	11.519	12.189		
February 2000 Control*	9.541	10.288	11.362	12.161		
November 2000 Control	9.448	10.059	11.243	12.887	13.717	14.577
Minnesota's Proxy Share of U.S. Construction Spending						
November 1996 Control	5.243	5.356				
February 1997 Control	5.290	5.344				
November 1997 Control	5.752	6.018				
February 1998 Control	5.810	6.066				
November 1998 Control	5.983	6.259	6.620	6.927		
February 1999 Control	5.983	6.593	6.872	7.081		
November 1999 Control	6.018	6.727	7.278	7.671		
February 2000 Control*	6.126	6.863	7.404	7.540		
November 2000 Control	6.213	6.904	7.595	7.677	7.985	8.507

* Reflects data revision.

Factors Affecting Sales, Corporate Income And Sales Tax on Motor Vehicles

(\$ in billions)

	Fiscal Year					
	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
SALES TAX (Cont.)						
Minnesota's Non-Farm Personal Income						
November 1996 Control	121.93	127.60				
February 1997 Control	121.03	128.57				
November 1997 Control	127.68	133.13				
February 1998 Control	128.73	133.98				
November 1998 Control	129.20	135.40	141.19	147.71		
February 1999 Control	129.58	136.44	142.42	148.03		
November 1999 Control*	126.46	133.73	141.35	147.91		
February 2000 Control	126.46	133.76	142.37	149.75		
November 2000 Control	133.41	142.02	152.34	161.70	170.86	181.54
SALES TAX ON MOTOR VEHICLES						
Minnesota's Proxy Share of U.S. Consumption of Motor Vehicle and Parts						
November 1996 Control	5.582	5.806				
February 1997 Control	5.404	5.625				
November 1997 Control**	5.191	5.339				
February 1998 Control	5.293	5.392				
November 1998 Control	5.550	5.575	5.718	5.900		
February 1999 Control	5.576	5.955	5.803	6.039		
November 1999 Control*	5.519	6.066	6.425	6.519		
February 2000 Control	5.519	6.068	6.574	6.517		
November 2000 Control	5.513	6.099	6.646	6.671	6.764	7.452
CORPORATE FRANCHISE TAX						
U.S. Corporate Profits						
November 1996 Control**	642.6	671.4				
February 1997 Control	659.6	677.8				
November 1997 Control	737.4	762.6				
February 1998 Control	756.3	754.3				
November 1998 Control	711.8	678.9	697.4	710.9	697.4	710.9
February 1999 Control	725.6	732.1	678.9	688.4	678.9	688.4
November 1999 Control*	781.9	853.9	883.8	894.2	883.8	894.2
February 2000 Control	781.9	855.3	849.7	823.4	849.7	823.4
November 2000 Control	758.2	823.0	940.7	910.0	993.5	1,089.0

* Data Revision.

** Change in Definition

Current Biennium Forecast Comparison

November 2000 vs End of Session

(\$ in thousands)

	5-00 Enacted FY 2000-01	11-00 Fcst FY 2000-01	\$ Difference
<u>Actual & Estimated Resources</u>			
Balance Forward from Prior Year	1,920,779	1,920,779	0
Current Resources:			
Net Non-Dedicated Revenue			
Individual Income Tax	11,035,993	11,440,966	404,973
Sales Tax	6,910,326	7,059,598	149,272
Corporate Income Tax	1,482,025	1,662,129	180,104
Motor Vehicle Sales Tax	1,055,400	1,077,361	21,961
Tobacco Settlements	222,067	219,755	(2,312)
Other Non-Dedicated Revenue	2,322,532	2,438,039	115,507
Subtotal Net Non-Dedicated Revenue	23,028,343	23,897,848	869,505
Dedicated Revenue	313,571	313,170	(401)
Transfers In	483,426	472,803	(10,623)
Prior Year Adjustments	20,200	26,371	6,171
Subtotal-Current Resources	23,845,540	24,710,192	864,652
Total Resources Available	25,766,319	26,630,971	864,652
<u>Actual & Estimated Spending by Function</u>			
Education / Children & Families	8,282,133	8,297,734	15,601
Post-Secondary Education	2,641,422	2,641,776	354
Property Tax Aids & Credits	3,293,666	3,288,449	(5,217)
Other Major Local Assistance	1,168,890	1,165,489	(3,401)
Health Care	3,752,873	3,698,211	(54,662)
Family Support	430,779	433,913	3,134
State Operated Institutions	963,085	956,241	(6,844)
Legisl., Judicial, Const. Officers	602,086	619,408	17,322
State Agencies' Operations & Grants	2,019,366	1,993,260	(26,106)
Debt Service	578,681	567,191	(11,490)
Capital Projects	88,850	88,850	0
Transportation Projects/Tabs	570,476	569,404	(1,072)
Estimated Cancellations	(34,340)	(22,000)	12,340
Subtotal-Major Spending Categories	24,357,967	24,297,926	(60,041)
Dedicated Expenditures	282,346	300,941	18,595
Total Expenditures & Transfers	24,640,313	24,598,867	(41,446)
Balance Before Reserves	1,126,006	2,032,104	906,098
Cash Flow Account	350,000	350,000	0
Budget Reserve	622,000	622,000	0
Dedicated Reserves	145,272	136,011	(9,261)
Budgetary Balance	8,734	924,093	915,359

November 2000 Forecast
Current Biennium
(\$ in thousands)

	Actual FY 2000	11-00 Fcst FY 2001	11-00 Fcst FY 2000-01
<u>Actual & Estimated Resources</u>			
Balance Forward from Prior Year	1,920,779	2,125,409	1,920,779
Current Resources:			
Net Non-Dedicated Revenue			
Individual Income Tax	5,556,366	5,884,600	11,440,966
Sales Tax	3,120,309	3,939,289	7,059,598
Corporate Income Tax	800,129	862,000	1,662,129
Motor Vehicle Sales Tax	540,961	536,400	1,077,361
Tobacco Settlements	104,926	114,829	219,755
Other Non-Dedicated Revenue	1,135,503	1,302,536	2,438,039
Subtotal Net Non-Dedicated Revenue	11,258,194	12,639,654	23,897,848
Dedicated Revenue	171,415	141,755	313,170
Transfers In	235,036	237,767	472,803
Prior Year Adjustments	16,271	10,100	26,371
Subtotal-Current Resources	11,680,916	13,029,276	24,710,192
Total Resources Available	13,601,695	15,154,685	26,630,971
<u>Actual & Estimated Spending by Function</u>			
Education / Children & Families	3,960,379	4,337,355	8,297,734
Post-Secondary Education	1,279,584	1,362,192	2,641,776
Property Tax Aids & Credits	1,567,098	1,721,351	3,288,449
Other Major Local Assistance	542,597	622,892	1,165,489
Health Care	1,720,839	1,977,372	3,698,211
Family Support	221,270	212,643	433,913
State Operated Institutions	450,002	506,239	956,241
Legisl., Judicial, Const. Officers	271,897	347,511	619,408
State Agencies' Operations & Grants	959,394	1,033,866	1,993,260
Debt Service	255,190	312,001	567,191
Capital Projects	88,850	0	88,850
Transportation Projects/Tabs	0	569,404	569,404
Estimated Cancellations	0	(22,000)	(22,000)
Subtotal-Major Spending Categories	11,317,100	12,980,826	24,297,926
Dedicated Expenditures	159,186	141,755	300,941
Total Expenditures & Transfers	11,476,286	13,122,581	24,598,867
Balance Before Reserves	2,125,409	2,032,104	2,032,104
Cash Flow Account	350,000	350,000	350,000
Budget Reserve	622,000	622,000	622,000
Dedicated Reserves	137,713	136,011	136,011
Appropriations Carried Forward	270,020	N/A	N/A
Budgetary Balance	745,676	924,093	924,093

Biennial Comparison
FY 2002-03 vs FY 2000-01
(\$ in thousands)

	11-00 Fcst FY 2000-01	11-00 Plng Est FY 2002-03	\$ Difference	% Change
<u>Actual & Estimated Resources</u>				
Balance Forward from Prior Year	1,920,779	2,032,104	111,325	5.8%
Current Resources:				
Net Non-Dedicated Revenue				
Individual Income Tax	11,440,966	13,293,300	1,852,334	16.2%
Sales Tax	7,059,598	8,599,889	1,540,291	21.8%
Corporate Income Tax	1,662,129	1,735,000	72,871	4.4%
Motor Vehicle Sales Tax	1,077,361	952,592	(124,769)	-11.6%
Tobacco Settlements	219,755	639,516	419,761	191.0%
Other Non-Dedicated Revenue	2,438,039	2,627,676	189,637	7.8%
Subtotal Net Non-Dedicated Revenue	23,897,848	27,847,973	3,950,125	16.5%
Dedicated Revenue	313,170	282,548	(30,622)	-9.8%
Transfers In	472,803	59,896	(412,907)	-87.3%
Prior Year Adjustments	26,371	20,200	(6,171)	-23.4%
Subtotal-Current Resources	24,710,192	28,210,617	3,500,425	14.2%
Total Resources Available	26,630,971	30,242,721	3,611,750	13.6%
<u>Actual & Estimated Spending by Function</u>				
Education / Children & Families	8,297,734	8,825,094	527,360	6.4%
Post-Secondary Education	2,641,776	2,748,962	107,186	4.1%
Property Tax Aids & Credits	3,288,449	3,543,041	254,592	7.7%
Other Major Local Assistance	1,165,489	1,207,902	42,413	3.6%
Health Care	3,698,211	4,746,748	1,048,537	28.4%
Family Support	433,913	444,839	10,926	2.5%
State Operated Institutions	956,241	1,023,436	67,195	7.0%
Legisl., Judicial, Const. Officers	619,408	640,093	20,685	3.3%
State Agencies' Operations & Grants	1,993,260	1,853,841	(139,419)	-7.0%
Debt Service	567,191	632,392	65,201	11.5%
Capital Projects	88,850	15,000	(73,850)	-83.1%
Transportation Projects/Tabs	569,404	180,723	(388,681)	na
Estimated Cancellations	(22,000)	(20,000)	2,000	na
Subtotal-Major Spending Categories	24,297,926	25,842,071	1,544,145	6.4%
Dedicated Expenditures	300,941	282,548	(18,393)	-6.1%
Total Expenditures & Transfers	24,598,867	26,124,619	1,525,752	6.2%
Balance Before Reserves	2,032,104	4,118,102	2,085,998	
Cash Flow Account	350,000	350,000	0	
Budget Reserve	622,000	622,000	0	
Dedicated Reserves	136,011	110,599	(25,412)	
Budgetary Balance	924,093	3,035,503	2,111,410	

FY 2002-03 General Fund Planning Estimates
Base, Inflation, Total
(\$ in thousands)

	11-00 Fcst Base FY 2002-03	Inflation FY 2002-03	11-00 Plng Est FY 2002-03
<u>Actual & Estimated Resources</u>			
Balance Forward from Prior Year	2,032,104	0	2,032,104
Current Resources:			
Net Non-Dedicated Revenue			
Individual Income Tax	13,293,300	0	13,293,300
Sales Tax	8,599,889	0	8,599,889
Corporate Income Tax	1,735,000	0	1,735,000
Motor Vehicle Sales Tax	952,592	0	952,592
Tobacco Settlements	639,516	0	639,516
Other Non-Dedicated Revenue	2,627,676	0	2,627,676
Subtotal Net Non-Dedicated Revenue	27,847,973	0	27,847,973
Dedicated Revenue	282,548	0	282,548
Transfers In	59,896	0	59,896
Prior Year Adjustments	20,200	0	20,200
Subtotal-Current Resources	28,210,617	0	28,210,617
Total Resources Available	30,242,721	0	30,242,721
<u>Actual & Estimated Spending by Function</u>			
Education / Children & Families	8,566,392	258,702	8,825,094
Post-Secondary Education	2,668,253	80,709	2,748,962
Property Tax Aids & Credits	3,438,108	104,933	3,543,041
Other Major Local Assistance	1,172,434	35,468	1,207,902
Health Care	4,605,395	141,353	4,746,748
Family Support	431,799	13,040	444,839
State Operated Institutions	993,420	30,016	1,023,436
Legisl., Judicial, Const. Officers	621,323	18,770	640,093
State Agencies' Operations & Grants	1,800,317	53,524	1,853,841
Debt Service	632,392	0	632,392
Capital Projects	15,000	0	15,000
Transportation Projects/Tabs	180,723	0	180,723
Estimated Cancellations	(20,000)	0	(20,000)
Subtotal-Major Spending Categories	25,105,556	736,515	25,842,071
Dedicated Expenditures	282,548	0	282,548
Total Expenditures & Transfers	25,388,104	736,515	26,124,619
Balance Before Reserves	4,854,617	(736,515)	4,118,102
Cash Flow Account	350,000		350,000
Budget Reserve	622,000		622,000
Dedicated Reserves	110,599		110,599
Budgetary Balance	3,772,018	(736,515)	3,035,503

2002-03 Biennial Comparison
November 2000 vs End of Session
(\$ in thousands)

	5-00 Plng Est FY 2002-03	11-00 Plng Est FY 2002-03	\$ Difference
<u>Actual & Estimated Resources</u>			
Balance Forward from Prior Year	1,126,006	2,032,104	906,098
Current Resources:			
Net Non-Dedicated Revenue			
Individual Income Tax	12,460,565	13,293,300	832,735
Sales Tax	8,224,220	8,599,889	375,669
Corporate Income Tax	1,475,085	1,735,000	259,915
Motor Vehicle Sales Tax	906,900	952,592	45,692
Tobacco Settlements	650,920	639,516	(11,404)
Other Non-Dedicated Revenue	2,514,715	2,627,676	112,961
Subtotal Net Non-Dedicated Revenue	26,232,405	27,847,973	1,615,568
Dedicated Revenue	282,456	282,548	92
Transfers In	50,500	59,896	9,396
Prior Year Adjustments	20,200	20,200	0
Subtotal-Current Resources	26,585,561	28,210,617	1,625,056
Total Resources Available	27,711,567	30,242,721	2,531,154
<u>Actual & Estimated Spending by Function</u>			
Education / Children & Families	8,877,403	8,825,094	(52,310)
Post-Secondary Education	2,781,985	2,748,962	(33,023)
Property Tax Aids & Credits	3,642,315	3,543,041	(99,273)
Other Major Local Assistance	1,209,630	1,207,902	(1,728)
Health Care	4,723,540	4,746,748	23,208
Family Support	433,197	444,839	11,641
State Operated Institutions	1,048,960	1,023,436	(25,524)
Legisl., Judicial, Const. Officers	587,753	640,093	52,340
State Agencies' Operations & Grants	1,848,738	1,853,841	5,103
Debt Service	631,088	632,392	1,304
Capital Projects	15,000	15,000	0
Transportation Projects/Tabs	180,723	180,723	0
Estimated Cancellations	(20,000)	(20,000)	0
Subtotal-Major Spending Categories	25,960,333	25,842,071	(118,262)
Dedicated Expenditures	282,456	282,548	92
Total Expenditures & Transfers	26,242,789	26,124,619	(118,170)
Balance Before Reserves	1,468,778	4,118,102	2,649,324
Cash Flow Account	350,000	350,000	0
Budget Reserve	622,000	622,000	0
Dedicated Reserves	145,272	110,599	(34,673)
Budgetary Balance	351,506	3,035,503	2,683,997

Planning Estimate Comparison FY 2004-05 vs FY 2002-03

(\$ in thousands)

	11-00 Plng Est FY 2002-03	11-00 Plng Est FY 2004-05	\$ Difference	% Change
<u>Actual & Estimated Resources</u>				
Balance Forward from Prior Year	2,032,104	4,118,102	2,085,998	102.7%
Current Resources:				
Net Non-Dedicated Revenue				
Individual Income Tax	13,293,300	15,255,700	1,962,400	14.8%
Sales Tax	8,599,889	9,665,462	1,065,573	12.4%
Corporate Income Tax	1,735,000	2,025,200	290,200	16.7%
Motor Vehicle Sales Tax	952,592	859,316	(93,276)	-9.8%
Tobacco Settlements	639,516	391,636	(247,880)	-38.8%
Other Non-Dedicated Revenue	2,627,676	2,711,195	83,519	3.2%
Subtotal Net Non-Dedicated Revenue	27,847,973	30,908,509	3,060,536	11.0%
Dedicated Revenue	282,548	282,548	0	0.0%
Transfers In	59,896	60,570	674	1.1%
Prior Year Adjustments	20,200	20,200	0	0.0%
Subtotal-Current Resources	28,210,617	31,271,827	3,061,210	10.9%
Total Resources Available	30,242,721	35,389,929	5,147,208	17.0%
<u>Actual & Estimated Spending by Function</u>				
Education / Children & Families	8,825,094	9,311,542	486,448	5.5%
Post-Secondary Education	2,748,962	2,923,705	174,743	6.4%
Property Tax Aids & Credits	3,543,041	3,827,425	284,384	8.0%
Other Major Local Assistance	1,207,902	1,291,445	83,542	6.9%
Health Care	4,746,748	5,864,904	1,118,156	23.6%
Family Support	444,839	460,711	15,872	3.6%
State Operated Institutions	1,023,436	1,093,060	69,624	6.8%
Legisl., Judicial, Const. Officers	640,093	673,412	33,319	5.2%
State Agencies' Operations & Grants	1,853,841	1,935,505	81,663	4.4%
Debt Service	632,392	656,130	23,738	3.8%
Capital Projects	15,000	35,000	20,000	133.3%
Transportation Projects/Tabs	180,723	0	(180,723)	na
Estimated Cancellations	(20,000)	(20,000)	0	na
Subtotal-Major Spending Categories	25,842,071	28,052,839	2,210,768	8.6%
Dedicated Expenditures	282,548	282,548	0	0.0%
Total Expenditures & Transfers	26,124,619	28,335,387	2,210,768	8.5%
Balance Before Reserves	4,118,102	7,054,542	2,936,440	
Cash Flow Account	350,000	350,000	0	
Budget Reserve	622,000	622,000	0	
Dedicated Reserves	110,599	103,547	(7,052)	
Budgetary Balance	3,035,503	5,978,995	2,943,492	

FY 2000-2005 Planning Horizon
November 2000 General Fund Forecast
(\$ in thousands)

	11-00 Fcst FY 2000-01	11-00 Plng Est FY 2002-03	11-00 Plng Est FY 2004-05
<u>Actual & Estimated Resources</u>			
Balance Forward from Prior Year	1,920,779	2,032,104	4,118,102
Current Resources:			
Net Non-Dedicated Revenue			
Individual Income Tax	11,440,966	13,293,300	15,255,700
Sales Tax	7,059,598	8,599,889	9,665,462
Corporate Income Tax	1,662,129	1,735,000	2,025,200
Motor Vehicle Sales Tax	1,077,361	952,592	859,316
Tobacco Settlements	219,755	639,516	391,636
Other Non-Dedicated Revenue	2,438,039	2,627,676	2,711,195
Subtotal Net Non-Dedicated Revenue	23,897,848	27,847,973	30,908,509
Dedicated Revenue	313,170	282,548	282,548
Transfers In	472,803	59,896	60,570
Prior Year Adjustments	26,371	20,200	20,200
Subtotal-Current Resources	24,710,192	28,210,617	31,271,827
Total Resources Available	26,630,971	30,242,721	35,389,929
<u>Actual & Estimated Spending by Function</u>			
Education / Children & Families	8,297,734	8,825,094	9,311,542
Post-Secondary Education	2,641,776	2,748,962	2,923,705
Property Tax Aids & Credits	3,288,449	3,543,041	3,827,425
Other Major Local Assistance	1,165,489	1,207,902	1,291,445
Health Care	3,698,211	4,746,748	5,864,904
Family Support	433,913	444,839	460,711
State Operated Institutions	956,241	1,023,436	1,093,060
Legisl., Judicial, Const. Officers	619,408	640,093	673,412
State Agencies' Operations & Grants	1,993,260	1,853,841	1,935,505
Debt Service	567,191	632,392	656,130
Capital Projects	88,850	15,000	35,000
Transportation Projects/Tabs	569,404	180,723	0
Estimated Cancellations	(22,000)	(20,000)	(20,000)
Subtotal-Major Spending Categories	24,297,926	25,842,071	28,052,839
Dedicated Expenditures	300,941	282,548	282,548
Total Expenditures & Transfers	24,598,867	26,124,619	28,335,387
Balance Before Reserves	2,032,104	4,118,102	7,054,542
Cash Flow Account	350,000	350,000	350,000
Budget Reserve	622,000	622,000	622,000
Dedicated Reserves	136,011	110,599	103,547
Budgetary Balance	924,093	3,035,503	5,978,995

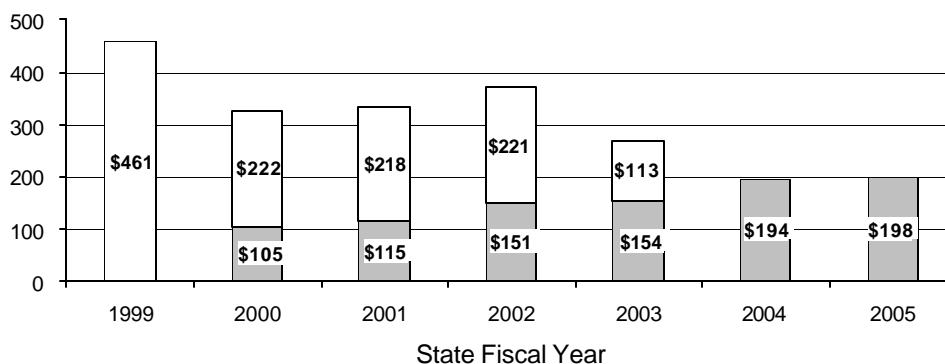
FY 2004-05 General Fund Planning Estimates
Base, Inflation, Total
(\$ in thousands)

	11-00 Fcst Base FY 2004-05	Inflation FY 2004-05	11-00 Plng Est FY 2004-05
<u>Actual & Estimated Resources</u>			
Balance Forward from Prior Year	4,118,102	0	4,118,102
Current Resources:			
Net Non-Dedicated Revenue			
Individual Income Tax	15,255,700	0	15,255,700
Sales Tax	9,665,462	0	9,665,462
Corporate Income Tax	2,025,200	0	2,025,200
Motor Vehicle Sales Tax	859,316	0	859,316
Tobacco Settlements	391,636	0	391,636
Other Non-Dedicated Revenue	2,711,195	0	2,711,195
Subtotal Net Non-Dedicated Revenue	30,908,509	0	30,908,509
Dedicated Revenue	282,548	0	282,548
Transfers In	60,570	0	60,570
Prior Year Adjustments	20,200	0	20,200
Subtotal-Current Resources	31,271,827	0	31,271,827
Total Resources Available	35,389,929	0	35,389,929
<u>Actual & Estimated Spending by Function</u>			
Education / Children & Families	8,623,566	687,976	9,311,542
Post-Secondary Education	2,707,786	215,919	2,923,705
Property Tax Aids & Credits	3,542,236	285,189	3,827,425
Other Major Local Assistance	1,196,037	95,408	1,291,445
Health Care	5,429,033	435,871	5,864,904
Family Support	426,704	34,007	460,711
State Operated Institutions	1,012,274	80,786	1,093,060
Legisl., Judicial, Const. Officers	623,672	49,740	673,412
State Agencies' Operations & Grants	1,794,685	140,820	1,935,505
Debt Service	656,130	0	656,130
Capital Projects	35,000	0	35,000
Transportation Projects/Tabs	0	0	0
Estimated Cancellations	(20,000)	0	(20,000)
Subtotal-Major Spending Categories	26,027,123	2,025,716	28,052,839
Dedicated Expenditures	282,548	0	282,548
Total Expenditures & Transfers	26,309,671	2,025,716	28,335,387
Balance Before Reserves	9,080,258	(2,025,716)	7,054,542
Cash Flow Account	350,000	0	350,000
Budget Reserve	622,000	0	622,000
Dedicated Reserves	103,547	0	103,547
Budgetary Balance	8,004,711	(2,025,716)	5,978,995

Tobacco Settlement Payments

November 2000 Forecast

(\$ in millions)



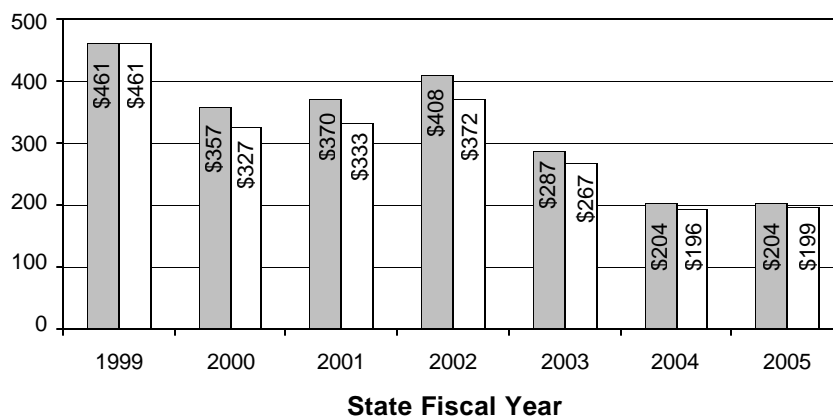
■ Annual Payments □ Settlement Payments

	F.Y. 1999	F.Y. 2000-01	F.Y. 2002-03	F.Y. 2004-05
Annual Payments	\$0	\$219.7	\$305.4	\$391.7
Settlement Payments	\$460.8	\$440.2	\$334.2	\$0
Total	\$460.8	\$659.9	\$639.6	\$391.7

Tobacco Settlement Revenues

Original Estimates vs. November 2000 Forecast

(\$ in millions)

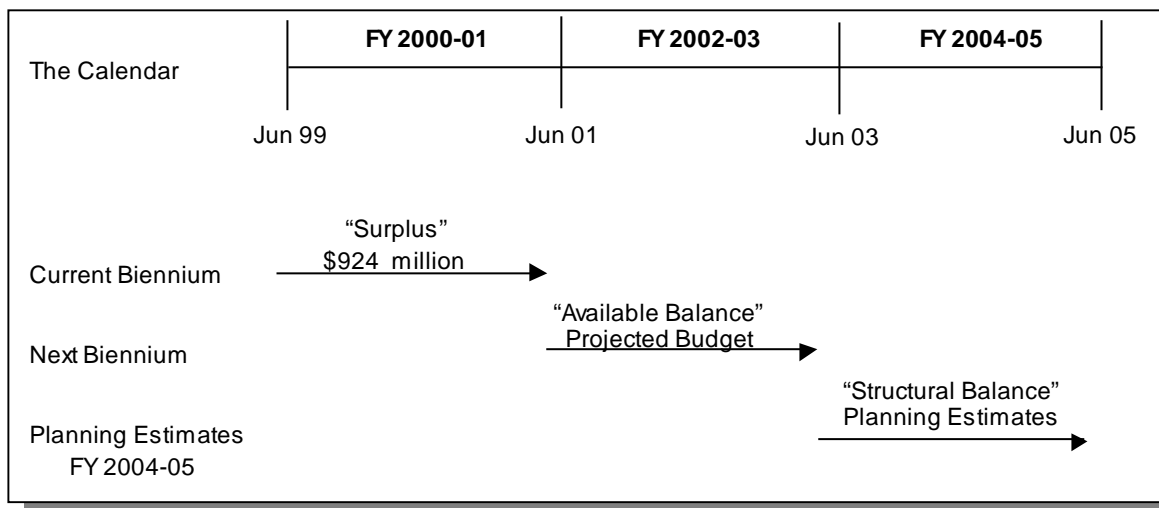


■ Original Payments □ Actual and Forecasted Payments

Original estimates of Settlement Revenues were included in the November, 1998 Forecast.

The Forecast “Calendar”

The projections contained in the November forecast cover parts of six years and three state biennial budget periods. It is important that state policy makers understand the nature of forecast balances, the time periods covered by the forecast, and significant risks in forecasting thirty-one and fifty-five months into the future.



Current biennium:

A projected surplus of \$924 million designated as available for a tax rebate during the summer of 2001. By the end of January, more than one-half of the \$915 forecast increase will be in the bank. The remainder will be received between then and June 30, 2001. Since seven months remain in the current biennium, it is certain that the final balance will be either higher or lower than forecast.

Future Budgets:

The revenue estimates for FY 2002-03 are the first detailed forecast of state revenues for the coming biennium. Prior revenue figures were only simple extrapolations based on long term trends. The FY 2002-03 expenditure estimates are simply updated planning estimates of state spending. The planning estimates reflect only current authorized spending, adjusted for enrollment and caseload, and include an estimate of expected inflation during the period.

Forecast as the Starting Point:

Forecast revenue and estimated expenditures provide the starting point for the development of the FY 2002-03 biennial budget. There is no approved budget in place. The Governor and state legislators should recognize potential forecast volatility in determining appropriate tax and spending initiatives, as well as in assessing the need to set aside adequate reserves for the next biennium.